
IN THE
United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 15724

FRED C. NIEDERKROME, E. ROYCE, DORA F. ROYCE, EZRA ROYCE, B. ROYCE, ESTATE OF ISABELLE H. ROYCE, DECEASED, B. ROYCE, Executor, ROBERT T. JACOB, AGNES C. JACOB, ALBERT L. SCHNEIDER and BERTHA SCHNEIDER,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

On Petitions for Review of the Decisions of the
Tax Court of the United States

BRIEF FOR PETITIONERS

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CEASED, B. ROYCE, EXECUTOR, ROBERT T. JACOB, AGNES
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Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

On Petitions for Review of the Decisions of the
Tax Court of the United States

BRIEF FOR PETITIONERS

OPINION BELOW

The memorandum opinion of the Tax Court (R. 216-
296) is not officially reported.

JURISDICTION

These consolidated cases involve asserted deficiencies in individual income taxes and additions to taxes under section 294(d)(2) of the Internal Revenue Code of 1939. The decisions of the Tax Court were entered on April 2, 1957, and redetermined deficiencies as follows (R. 296-302):

Petitioners	Taxable Years	Income Taxes	Additions to Taxes
Fred C. Niederkrome	1945	\$ 32,348.48	\$1,940.07
E. Royce and Dora F. Royce	1948	22,191.08	
	1949	22,453.94	
Ezra Royce	1944	54,875.50	
	1945	269,786.82	
	1946	127,263.95	
	1947	76,771.18	4,882.58
B. Royce	1945	17,795.86	
Estate of Isabelle H. Royce	1945	29,308.54	
Robert T. Jacob and Agnes C. Jacob	1945	66,977.56	4,035.66
Albert L. Schneider and Bertha Schneider	1945	21,157.87	1,102.38

Petitions for review were filed on July 1, 1957. The jurisdiction of this Court is invoked under sections 7482 and 7483 of the Internal Revenue Code of 1954.

QUESTIONS PRESENTED

The following questions are presented:

(1) Whether any portion of the \$350,000 paid by Oregon Motor Stages to L. R. Bentson in retirement of all his stock, or any portion of the incidental disbursements paid by Oregon Motor Stages, is taxable as a dividend to each of the other stockholders of the corporation.

(2) Whether the sum of \$20,000 advanced by Hippodrome Amusement Company to the petitioner E. Royce is taxable to him as a dividend.

(3) Whether the petitioner E. Royce is taxable with respect to the income of a partnership doing business as Yellow Cab Company, in Portland, Oregon, which was distributable to his wife Dora F. Royce.

(4) Whether the petitioner E. Royce is taxable with respect to the income of a partnership doing business as Yellow Cab Company, in Seattle, Washington, which was distributable to his wife Dora F. Royce.

(5) Whether the petitioners E. Royce and Dora F. Royce are taxable with respect to the income of a partnership doing business as Yellow Cab Company, in Seattle, Washington, which was distributable to a trust for the benefit of their daughter Eunice M. Royce.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are printed in the Appendix, *infra*, pp. 1a-4a.

STATEMENT

These consolidated proceedings involve nine taxpayers. E. Royce and Dora F. Royce, Robert T. Jacob and Agnes C. Jacob, and Albert L. Schneider and Bertha Schneider are, respectively, husband and wife. B. Royce and Isabelle H. Royce were husband and wife before her death. (R. 220-221.)

The petitions for review present five basic issues. The facts relating to each issue are separately summarized.

I.

Oregon Motor Stages

Oregon Motor Stages, hereinafter called Stages, was a corporation organized in Oregon, where it operated an intrastate bus line. In June, 1945, its outstanding stock consisted of 750 shares of common stock. L. D. Jones and

T. D. Wilson each owned 250 shares; and R. W. Lemon or members of his family owned the balance. (R. 221.)

In April or May, 1945, Schneider advised E. Royce that the stock of Stages was for sale. (R. 222, 315-316, 336, 353, 362, 387, 401, 592.) E. Royce and Jacob promptly began to negotiate for the purchase of the stock. At the same time they invited others to join them in the purchase. (R. 222, 316, 336-337, 352-353, 363, 366, 387-388, 399, 620-621.) After various discussions B. Royce, Niederkrome and Schneider, together with E. Royce and Jacob, were willing to buy a total of 400 shares at \$1,000 per share. (R. 222, 316, 345, 388.) They all regarded Stages as a good investment. The war had greatly increased its earnings and it had been paying substantial dividends. Military patronage accounted for over half of its revenues. Civilian patronage was a good deal larger because of gas rationing. They expected that the war with Japan would continue for some time and keep the earnings at the same high level. (R. 319-321, 339-340, 349, 352, 369-370, 377, 393-394.)

Since they were unwilling to buy more than 400 shares, they sought additional purchasers for the other 350 shares. (R. 222, 316-317, 337, 352-353, 366, 387-388, 399, 620-621.) They also considered having the corporation acquire the 350 shares, and the attorney for the selling group drafted an agreement for that purpose. (R. 222, 239, 316.) While discussions were going on, L. R. Bentson, an uncle of E. Royce and B. Royce, visited Portland in June. (R. 222, 316-317, 388-389, 402.) Bentson lived in Vancouver, B. C., and came to Portland periodically. (R. 356, 388, 572.) He had once been a successful mining operator in Alaska, and had later gone into a sawmill business. (R. 239, 317, 356, 390, 604.) He was very impressed by the financial success of his nephews, and on various occasions had expressed a desire to go into their business ventures. (R. 328, 390.)

E. Royce mentioned the pending negotiations to Bentson, who then became interested in acquiring the 350

shares. (R. 316-318, 363-364, 388, 390.) As a result, Jacob and Schneider met with Bentson at the home of E. Royce. (R. 317-318, 338-339, 363-364, 381, 389.) Before going into the transaction Bentson asked Schneider to take him over the bus routes. For more than two days they both inspected the routes, checked the operations at each depot, and looked at the various shops and facilities. (R. 328, 364-365, 380.) Bentson examined Stages' records, including profit and loss statements, as well as other data on operating revenues and operating ratios. (R. 328, 365-366, 391.) He also spent several hours with the comptroller of the corporation. (R. 365-366.) Bentson wished to build up an estate for a niece who lived in Portland, and decided that the 350 shares were a good investment toward this end. (R. 328, 391.)

In order to enable Bentson to finance his purchase, Jacob introduced him and E. Royce to George W. Davidson. The latter was vice-president and manager of American Business Credit Corporation, an Oregon corporation doing business in Portland, hereinafter referred to as ABC-Portland. (R. 209, 318, 336, 338, 343, 391, 404, 585.) Bentson applied to ABC-Portland for a loan of \$350,000 and negotiated with Davidson. (R. 391, 403-404, 585.) The loan was approved on two conditions. E. Royce was required to sign the note of indebtedness as an accommodation maker, and the entire 750 shares had to be pledged as collateral. (R. 319, 335, 351, 359, 391-392, 396-397, 404-406.) ABC-Portland imposed these conditions because Bentson was a Canadian citizen. (R. 319, 379, 396-397.) It was felt that if Stages' earnings continued at the same rate, Bentson would be able to make substantial repayments out of distributions. (R. 379, 407.) It was also understood, on the basis of ABC-Portland's practice, that such loans were customarily renewed for a number of years. (R. 340-341, 378.)

The 750 shares were bought on July 2, 1945, at \$1,000 a share. (R. 224-225.) The participants at the closing were

Niederkrone, E. Royce, Jacob, Schneider, Bentson, the sellers Jones and Lemon, the attorney for the sellers, and a representative of ABC-Portland. (R. 321-322, 327, 367, 373, 393.) ABC-Portland issued a check for \$350,000, payable to Bentson and E. Royce. (R. 225; Ex. B.) Bentson then bought a cashier's check in the same amount which he turned over to the sellers. (R. 321-322, 326-327; Ex. 7.) Each of the other purchasers similarly paid for his stock with a cashier's check. (R. 321-322, 325-327, 366-367; Ex. 8.) E. Royce loaned Niederkrone the \$55,000 which he needed for his purchase, and also advanced \$50,000 to Schneider for a few days. (R. 232, 355-356, 366-367, 375, 400, 623.) The sellers transferred the 750 shares to the purchasers as follows: Niederkrone—55; E. Royce—145; B. Royce—50; Jacob—100; Schneider—50; and Bentson—350. (R. 224-225, 322-324.)

All the certificates of stock were immediately endorsed in blank and turned over to ABC-Portland as security for the loan of \$350,000. (R. 225, 319, 323-324, 341, 367-368, 392, 623.) Bentson gave the other purchasers signed receipts for their certificates, stating "such stock being loaned to me to be pledged to American Business Corporation as collateral to loan this day made to me for the purchase of Three Hundred Fifty (350) shares of the common capital stock of said company." (R. 225, 324-325, 341, 368-369, 392-393; Ex. 2-6.) On the same day ABC-Portland was given a note for \$350,000 signed by Bentson and E. Royce. The note was payable in 90 days, bore interest at 5 percent, and was secured by the stock of Stages. (R. 225-227, 391-392; Ex. 1.)

On July 17, 1945, Davidson billed Stages for \$4,315.07, representing a servicing fee for financing the loan. Two days later Stages issued a check in the same amount to Davidson. (R. 227, 332.) The cash receipts report of ABC-Portland, dated July 20, 1945, showed a receipt of \$4,315.07 from E. Royce and Bentson. (Ex. D.) The cash receipts

report of ABC-Portland dated September 17, 1945, showed an advance of \$350,000 to E. Royce and Bentson. (Ex. E.) Monthly statements of ABC-Portland for July, August, and September, 1945, carried an account in the names of E. Royce and Bentson. (Ex. G.)

In late August, 1945, Bentson informed Jacob, Schneider, and E. Royce that he wished to dispose of his stock. The war with Japan had suddenly ended, and he felt that Stages' earnings would decline. Moreover, he was greatly disturbed because he had just learned that his wife had cancer of the throat. (R. 328-329, 371-372, 395, 603-604.) In a letter dated August 31, 1945, Bentson offered to sell his 350 shares to Stages for an amount equal to \$350,000 plus accrued interest on the note held by ABC-Portland. "My object in desiring to dispose of this stock," he wrote, "is that the sudden end of the war has made a great difference to my plans, and on this account I desire to be relieved of my obligation to the said American Business Credit Corporation." (R. 227-228, 329, 409.)

Schneider tried to interest one Rothschild in the 350 shares, but Rothschild did not regard a short-line bus company as a good investment. (R. 385-386.) On September 5, 1945, the stockholders and directors of Stages met to consider Bentson's offer. After reviewing the applicable Oregon statutes and the financial condition of Stages they voted to purchase and cancel the 350 shares held by Bentson. (R. 229-231, 329.) Bentson attended the meeting. (R. 229.) The next day Stages bought and retired the 350 shares, and gave Bentson a check for \$350,000. (R. 231, 329.) Bentson endorsed the check and delivered it to ABC-Portland in discharge of the loan. The payment of \$350,000 was recorded on the books of Stages as a debit to surplus of \$315,000 and a debit to capital stock of \$35,000. (R. 231.) On September 17, 1945, Stages issued to ABC-Portland a check for \$3,739.73, the interest then due on the loan. On April 2,

1946, the authorized capital stock of Stages was reduced from \$75,000 to \$40,000. (R. 231, 331.) The earned surplus of Stages exceeded \$350,000 when the 350 shares were redeemed. (R. 233.)

E. Royce was president of Stages; Schneider was vice-president and general manager; Jacob was secretary; and Niederkrome was treasurer. All four were also directors. Neither Bentson nor B. Royce was ever an officer or director of Stages. Only Schneider was actually active in its affairs. (R. 212, 231-232, 335, 337-338, 348, 360, 362, 374, 407.) On June 20, 1946, Niederkrome sold his stock to Schneider for \$55,000. The Interstate Commerce Commission required Niederkrome to dispose of his stock because he was a director of another carrier. (R. 211-212, 232, 334, 348-349, 351, 356, 360, 375-376.)

Stages' net income and losses for 1945 through 1949 were as follows (Ex. Y, Z, AA, BB, CC):

<u>Year</u>	<u>Net Income or Losses</u>
1945	\$426,168.53
1946	153,318.31
1947	47,413.02
1948	16,911.54
1949	(69,409.01)

Bentson died in April, 1950. (R. 222, 318, 572.) His wife died about 1946. (R. 574.)

The Commissioner determined that the \$350,000 and \$3,739.73 paid on the redemption of Bentson's shares, and the \$4,315.07 previously paid to ABC-Portland, were taxable as dividend income to the other five stockholders—Niederkrome, E. Royce, B. Royce, Jacob and Schneider—or, in the alternative, to E. Royce alone. (R. 219, 236-237.) The Tax Court held that the sums in question were taxable to the five stockholders. (R. 236-244.)

II.

Hippodrome Amusement Company

Hippodrome Amusement Company, hereinafter called Hippodrome, is an Oregon corporation. In 1945 it owned improved and unimproved property at Seaside, Oregon. Most of the improved property was devoted to rental purposes, and the balance was used as a dance hall. (R. 257-258.) The outstanding stock of Hippodrome consisted of 353 shares. The stockholders were E. Royce, B. Royce, Niederkrome, and Stephen Bartle, who owned, respectively, 218, 111, 19, and 5 shares. All except Bartle were directors. E. Royce was president, and Niederkrome was secretary and auditor. (R. 258.)

On December 28, 1945, Hippodrome gave E. Royce a check of \$20,000. (R. 258.) Before the check was issued, E. Royce conferred with B. Royce and Niederkrome. He stated that he wished to borrow \$20,000 from Hippodrome, and that he would return the money when the corporation needed it. (R. 495-496.) B. Royce and Niederkrome consented to the advance on this basis. (R. 258, 412-413, 420, 495-496, 521-522, 566-567.) The disbursement was recorded on the corporate books by debiting an account receivable, entitled "Due from Stockholders," and crediting the cash account. (R. 258; Ex. 33, 34.) E. Royce did not execute any note or other evidence of indebtedness. (R. 258.) At the time of the hearing he had not yet repaid the \$20,000. (R. 258-259.)

In 1948 Hippodrome disbursed \$400 to Niederkrome. This sum was also charged to the account receivable entitled "Due from Stockholders." Niederkrome did not execute any note or other evidence of indebtedness. He had not repaid the \$400 at the time of the hearing. (R. 59.)

On April 1, 1954, Niederkrome opened new accounts on the books of Hippodrome, entitled "Notes Receivable—

E. Royce" and "Notes Receivable—F. C. Niederkrome." He debited these accounts in the respective sums of \$20,000 and \$400, and closed out the "Due from Stockholders" account. (R. 259-260; Ex. 34.)

Hippodrome operated at a loss before the war and carried a deficit for about 10 years in the 30's. (R. 260.) During that period E. Royce and B. Royce helped out by advancing moneys to it. The corporation never gave any notes for those loans. (R. 260, 495, 521-522.) By 1945 its financial condition had substantially improved. (R. 260.) Hippodrome operated on the basis of a fiscal year ending March 31st. (R. 260.) On March 31, 1945, its earned surplus was \$16,576.34. Its earnings for the year ending March 31, 1946, were \$5,127.06, and its earned surplus as of that date was \$21,703.40. (R. 260.)

In 1945 Hippodrome had no building program or plans for immediate expansion. (R. 260.) In 1948 or 1949 it made plans to build a ticket office and terminal for Stages. However, the project did not materialize. (R. 260-261.) In 1954 Hippodrome entered into negotiations with the Post Office Department to erect a post office building on its unimproved property. It had a preliminary sketch for the building prepared, but the negotiations eventually fell through. (R. 261.) At the time of the hearing Hippodrome was discussing the construction of new bus facilities with Pacific Greyhound, the largest motor operator on the West Coast. (R. 261.)

Since 1945 Hippodrome has not needed the \$20,000 which it advanced to E. Royce. (R. 419, 423.) If the negotiations with the Post Office Department had succeeded, the corporation would have required the sums disbursed to E. Royce and Niederkrome. (R. 419, 423, 501, 522, 524-526.) During those negotiations the stockholders considered the return of the \$20,000 and the \$400. (R. 501, 524-526.) At all times E. Royce and Niederkrome have intended to repay the advances when the corporation needs

the money, and at all times repayment has been expected. (R. 419-420, 496, 501-502, 526, 567.)

Neither B. Royce nor Bartle has ever received any advances from Hippodrome. There have been no withdrawals by stockholders, apart from the \$20,000 disbursed to E. Royce in 1945 and the \$400 disbursed to Niederkrome in 1948. (R. 500-501.)

The Tax Court held that the \$20,000 received by E. Royce from Hippodrome was taxable to him as a dividend. (R. 261-262.)

III.

Portland Partnership—Dora F. Royce

Before August 1, 1942, Yellow Cab Incorporated was an Oregon corporation engaged in the taxicab business in Portland, Oregon. (R. 263.) E. Royce owned about 49 percent of its outstanding stock. (Ex. 25.) On July 31, 1942, he transferred 14,000 shares, or slightly less than half of his stock, to his wife Dora F. Royce. (R. 263, 428.) On August 1, 1942, the corporation was liquidated and dissolved at a stockholders' meeting attended by Dora as well as other stockholders. (R. 263, 428, 446, 503-504, 533, 564-565.) On the same date all the stockholders formed a partnership, known as Yellow Cab Company, to operate the business previously conducted by the corporation. (R. 263-266, 428, 504, 533-534.)

All the prior stockholders signed articles of partnership. The parties to the agreement were E. Royce, B. Royce, Charles W. Keffer, C. H. Luton, Dora F. Royce, and Isabelle H. Royce. Under the terms of the agreement the partners assumed the liabilities of the corporation. The partnership was to "continue for the duration of the joint lives of the parties," unless otherwise dissolved by them. The stated capital of the partnership consisted of the assets formerly owned by the corporation, plus undistributed income and profits. The respective inter-

ests of the partners were specified as follows: E. Royce—26.1575%; B. Royce—26.1575%; Keffer—.659%; Luton—.906%; Dora—23.06%; and Isabelle—23.06%. Profits and losses were to be shared by the partners in proportion to their relative interests. Each partner had “an equal voice in the control of the business and operation of the partnership.” The partnership was required “to keep accurate books of account,” which were to be open to all the partners. Upon dissolution of the firm the surplus was to be divided among them according to their interests. (R. 263-266, 428-429, 507-508, 533-534; Ex. 25, 26.)

The opening journal entry of the partnership recorded the partners' capital accounts as follows (R. 506-508; Ex. 29, 30):

E. Royce	26.1575%	\$21,295.23
B. Royce	26.1575%	21,295.23
Charles H. Keffer	.659%	536.50
C. H. Luton	.906%	737.59
Dora F. Royce	23.06%	18,773.51
Isabelle H. Royce	23.06%	18,773.51

On December 3, 1942, the partnership filed an Assumed Business Name Certificate dated August 2, 1942. The Certificate listed six partners, including Dora, who signed the certificate. (R. 446, 534; Ex. 27.) On November 28, 1942, E. Royce and B. Royce purchased the interests of Luton and Keffer. (R. 266.)

E. Royce worked at the office, shop, and garage, where he made the everyday decisions. (R. 427, 451-452, 485.) On the average, he spent about half of his working time there. His other ventures absorbed the balance of his time and attention. (R. 485.) He also regularly handled those affairs at the office of the partnership. (R. 485-486.) B. Royce was inactive in the business. (R. 272, 518.)

Dora and E. Royce were married in 1923. (R. 387, 427, 527.) She was a woman of substantial business experi-

ence. Before marriage she had been a millinery designer and held positions of responsibility. Her business background included the executive supervision of employees, as well as control of overhead and other expenses. (R. 447-448, 527-528.) She regularly rendered services to the partnership as a checker. She checked the conduct of the drivers, the appearance of their uniforms, the condition of the cabs, and the number of passengers carried. She performed these services at hotels, stands, depots and other places where cabs regularly picked up or discharged passengers. Her observations were recorded in reports which she filed at the office. (R. 429-430, 451, 452, 487-488, 529-530, 536, 542-543.) The hours devoted by Dora to her checking duties varied. Often she would work all day. On other occasions she would work less. At times she did her checking in the evening. She was experienced in her work because she had performed the same services for the prior corporation. (R. 427, 430, 452, 530.) Her work was important to the business, and called for a person of experience and responsibility. (R. 430, 450-451, 484-485, 542.) Now and then E. Royce did some checking. (R. 451.) In the absence of Dora's services the partnership would have had to employ a checker to do her work. (R. 272, 467-468, 484-485.) Dora also attended partners' conferences, expressed her views, and kept herself informed about the business. (R. 445, 447, 536, 565-566.)

The drawing accounts of Dora and E. Royce on the books of the partnership show the following withdrawals during the taxable years 1944 through 1947:

Year	Dora	E. Royce
1944	\$ 48,777.75	\$ 58,184.94
1945	69,180.00	80,820.00
1946	48,865.01	57,086.99
1947	4,612.00	5,388.00
Total	\$171,434.76	\$201,479.93

At the end of 1947 the accumulated earnings distributable to Dora exceeded her withdrawals by \$35,434.76, and those distributable to E. Royce exceeded his withdrawals by \$38,395.26. (R. 272-273.) Whenever there was a distribution of profits, Dora received her share. (R. 430, 454.) All distributions to her were in the form of checks payable to her. (R. 273.)

Dora maintained a separate checking account at The First National Bank of Portland. (R. 273-274, 431, 535.) She never had a joint checking account with her husband. (R. 449, 455, 536.) The deposits to and withdrawals from her account for the years 1944 through 1947 were as follows (R. 274):

Year	Deposits	Withdrawals
1944	\$ 21,386.75	\$ 22,507.83
1945	38,712.25	36,114.11
1946	73,491.78	71,563.02
1947	46,485.00	50,106.19
Total	\$180,075.78	\$180,291.15

Dora endorsed all her distribution checks. (R. 273.) Part of the proceeds was directly deposited to her account. A substantial portion was placed in her safe deposit box. At one time she had about \$65,000 there. (R. 547-550, 570, 611.) Much of the cash set aside in her box was then used by her or deposited to her account. (R. 550, 570.) A number of the checks were endorsed by E. Royce as well as Dora, because the bank required his signature when she cashed them. (R. 610.)

Dora exercised her own judgment in spending or investing her funds. (R. 466-467, 535-536, 552-553.) Of her distributions from the Portland partnership and the Seattle partnership, considered at pp. 15-19, *infra*, she spent about \$1,850 for two fur coats, \$8,000 for two Chrysler automobiles, \$350 for an exercycle, \$1,800 for silverware, and \$400 for lace cloth. In addition, she bought a Ply-

mouth and Cadillac, purchased various furnishings for the home, acquired several hundred dollars worth of books, and spent about \$18,000 in improvements of the house. (R. 275, 431-433, 467, 531-533.) E. Royce provided for ordinary household expenses, such as food, light, heat, groceries, insurance, and taxes. (R. 433-434, 533.)

Dora invested \$7,000 in Government bonds and \$2,500 in Missouri-Pacific stock. (R. 275, 433, 456.) These securities were acquired in her own name. (R. 455-456.) She also loaned about \$70,000 to E. Royce to be invested in Alder Gold-Copper Company. (R. 275, 456-463, 542, 552.) E. Royce was interested in the promotion of that corporation. In 1949 he acquired about 5 percent of its common stock. (R. 214-215, 457-458, 460-463, 484, 489, 551-552; Ex. 45-SSSS, 46-TTTT, 47-UUUU.) Dora also had stock in the corporation. (R. 457-458.)

The Commissioner determined that Dora was not "a bona fide partner" in the Portland partnership, and taxed her share of the partnership profits for the years 1944-1947 to petitioner E. Royce. The Tax Court sustained the determination and the resulting deficiencies. (R. 275-278.)

IV.

Seattle Partnership—Dora F. Royce

Yellow Cab Company of Seattle was a Washington corporation which conducted a taxicab business in Seattle. (R. 266.) Its shares of outstanding stock were owned as follows (R. 266):

W. L. Rothschild	607½
J. A. Baldi	606
Geo. E. Worster	606
D. N. Newton	606
E. Royce	1,402½
B. Royce	1,402½
A. H. Wenck	269½

5,500

On April 20, 1944, E. Royce transferred 402½ shares to Dora and 700 shares to himself as trustee for his daughter Eunice M. Royce. (R. 267.) E. Royce duly filed a gift tax return covering both gifts of stock, and paid a gift tax of \$1,568.11. (R. 267; Ex. 16.)

On May 1, 1944, the corporation was liquidated and dissolved. (R. 266.) Dora attended the stockholders' meeting at which the dissolution was voted. (R. 446, 539-540, 616; Ex. 17.) On the same day the former stockholders and L. S. Ackerman signed Articles of Copartnership in order to carry on the business previously conducted by the corporation. In addition, they all executed a Certificate of Assumed Name, which was filed on June 12, 1944. Dora signed both documents. (R. 266-271, 437-438, 446, 540, 564-565; Ex. 19.) The Articles of Copartnership created a partnership, known as Yellow Cab Company, for a term of five years. The partnership was to continue for similar successive periods unless any party gave notice to the contrary. The capital of the business consisted of the assets of the dissolved corporation, subject to its liabilities, which the partners assumed. (R. 267-269.)

Wenck was designated managing partner at a monthly salary "determined from time to time by the partners." Apart from Wenck's duties as manager, the agreement provided that "decisions as to partnership matters shall be made by a majority in interest of the partners." B. Royce, E. Royce, Rothschild, and Baldi agreed to devote as much time to the business as they deemed necessary. Rothschild and Baldi were to serve without compensation. B. Royce and E. Royce were each to receive 2½ percent of the net profits, but not exceeding \$5,000. The balance of any profits and all losses were to be shared as follows:

Name	Fraction
B. Royce	1402½
	5500
E. Royce	300
	5500
E. Royce, Trustee for E. M. Royce	700
	5500
D. F. Royce	402½
	5500
A. H. Wenck	269½
	5500
W. L. Rothschild	485½
	5500
J. A. Baldi	485
	5500
G. E. Worster	485
	5500
D. N. Newton	485
	5500
L. S. Ackerman	485
	5500

No withdrawals of capital or payments of profits could "be made by or to any partner unless such withdrawals or payments" were "uniform as to all partners in proportion to their respective interests" and "authorized by decision of the partners." The agreement further re-

quired the partners to "act in the highest good faith toward each other." (R. 269-271; Ex. 18.)

The opening journal entry of the partnership recorded the partners' capital accounts as follows (Ex. 20):

B. Royce	\$79,902.18
E. Royce	17,091.23
E. Royce, Trustee for E. M. Royce	39,879.96
D. F. Royce	22,930.99
A. H. Wenck	15,353.76
W. L. Rothschild	27,659.32
J. A. Baldi	27,631.11
G. E. Worster	27,631.11
D. N. Newton	27,631.11
L. S. Ackerman	27,631.11

Wenck actively managed the business in accordance with the partnership agreement. (R. 438-439, 541, 615-616.) E. Royce visited the office infrequently. (R. 438, 541, 617.) Dora was there a little more often. (R. 617.) When she was in Seattle, she checked the cabs and drivers, and filed reports with Wenck. (R. 439, 540-541, 617-618.) She kept herself informed about the business. (R. 445.) While in Seattle she participated in partnership conferences and discussed business affairs with Wenck. (R. 439, 447, 540, 617.) An employee regularly performed the same services as Dora contributed to the Portland partnership. (R. 467-468.)

For the years 1945 through 1949 the withdrawals of Dora and E. Royce from the Seattle partnership were as follows:

Year	Dora F. Royce	E. Royce
1945	\$41,622.53	\$30,994.97
1946	19,662.53	14,644.97
1947	12,342.53	9,194.97
1948	12,342.53	9,194.97
1949	5,022.53	3,744.97
Total	\$90,992.65	\$67,774.85

At the end of 1949 the accumulated earnings distributable to Dora and E. Royce exceeded their withdrawals by the respective amounts of \$18,733.16 and \$14,008.75. (R. 272-273.) Dora received her proportionate share of distributions together with the other partners. (R. 439-440, 465-466, 619.) At the time of trial the partnership had suffered losses for two years. Dora's account was charged with her share of the losses. (R. 621.)

All partnership distributions to Dora were made by checks payable to her. (R. 465, 618-619.) She handled the checks in the same manner as those received from the Portland partnership. (R. 541.) See pp. 14-15, *supra*.

The Commissioner determined that Dora was not "a bona fide partner" in the Seattle partnership, and taxed her share of the partnership profits for the years 1945-1947 to petitioner E. Royce. The Tax Court sustained the determination and the resulting deficiencies. (R. 275-278.)

V.

Seattle Partnership—Trust for Eunice M. Royce

On April 20, 1944, E. Royce executed a declaration of trust with respect to 700 shares of stock in Yellow Cab Company of Seattle. (R. 267, 278.) E. Royce was the designated trustee and his daughter Eunice M. Royce was the beneficiary. The trust instrument provided that the net income was to be distributed to Eunice or accumulated for her use and benefit "as her absolute and separate property for and during the term of her natural life, or until this trust is sooner terminated" by the grantor's death or as otherwise provided. After Eunice became 35, she was to receive the corpus if the trustee or successor trustee considered her "capable of managing the trust estate wisely." E. Royce, as trustee, had broad administrative powers to sell, invest, and reinvest. (R. 278-282.) On the same date E. Royce, as trustee for Eunice, voted to dissolve Yellow Cab Company of Seattle, and signed the

Articles of Copartnership and the Certificate of Assumed Name of the successor partnership. (R. 267-271, 437-438; Ex. 19.)

Eunice was about 15 when the trust was created. (R. 267, 435.) Until 1947 she lived at home. (R. 443.) From 1947 to 1951 she attended the University of Oregon. From March, 1952 to March, 1954 she worked for the Imperial Travel Bureau. On June 12, 1954, she was married. (R. 282.)

The drawing account of E. Royce, trustee for E. M. Royce, on the books of the partnership shows the following withdrawals during the years 1944 through 1949 (Ex. 21):

<u>Year</u>	<u>Amount</u>
1944	\$46,922.49
1945	72,382.49
1946	34,192.49
1947	21,462.49
1948	21,462.49
1949	8,732.49
Total	\$205,154.94 ¹

At the end of 1949 the earnings distributable to E. Royce, as trustee, exceeded the withdrawals by \$32,592.59. This excess amount was retained in the business. (R. 283.) E. Royce, as trustee for Eunice, received a proportionate share of the distributions from the partnership. (R. 439-440, 471-472, 618.) All the distributions made to him as trustee were in the form of checks payable to him as trustee. (R. 471-472, 618-620.) At the time of trial the partnership

¹ The Tax Court finds that the total withdrawals were \$205,154.94, but it erroneously lists the distributions for the years 1944 through 1947 as \$16,422.49, \$77,422.49, \$46,922.49, and \$34,192.49. (R. 283.) These amounts are not in accord with Exhibit 21, from which the Tax Court derived its related findings on the distributions to Dora and E. Royce. See p. 18, *supra*. Exhibit 21 indicates the distributions to the trust, as well as Dora and E. Royce.

had suffered losses for two years. The trust's account was charged with its share of the losses. (R. 621.)

E. Royce deposited all the distributions in a trust account at The U.S. National Bank. (R. 283, 440, 512-513.) The account was in the name of E. Royce, Trustee for E. M. Royce. (R. 439.) During the years 1944 through 1949 Eunice had a personal checking account in The First National Bank. Over several years E. Royce transferred \$2,200 from the trust account to her personal account. (R. 284.) She drew on the personal account as she pleased for expenses while at college. (R. 448, 556-557.) The checks issued on the trust account during the years 1944 through 1949 totalled \$186,046.21, leaving a balance of \$19,108.73. (R.284.) They were directed to the following purposes (R. 284-285):

Payment of Federal and state taxes	\$89,464.96
Purchase of Government bonds	281.25
Transfer to Eunice's personal account	2,200.00
Loans to Royce, Inc.	7,100.00
Loans to E. Royce	87,000.00
	<hr/>
Total	\$186,046.21

E. Royce signed the checks on the trust account as E. Royce, Trustee for E. M. Royce; E. Royce, Trustee; or E. M. Royce, E. Royce Trustee. (Ex. 38.)

Royce, Inc. owned the Columbia Athletic Club Building. (R. 285.) E. Royce owned 50 percent of its stock and two other individuals owned the other 50 percent. (R. 479.) The loans to Royce, Inc. were made in 1948 and 1949, and repaid with interest in 1950. (R. 285, 478-479.) The loans to E. Royce were made in 1945 and 1946, and are evidenced by three renewal notes payable to Eunice and bearing interest at 3 percent. (R. 285, 441-442, 483-484; Ex. 39.) In 1953 and 1954 E. Royce paid \$5,515 on two of the notes, leaving a balance of \$81,485.00. (R. 286, 442.)

The Commissioner taxed to E. Royce the trust's share of the partnership profits for the years 1945-1949. The Tax Court sustained the determination. (R. 286-289.)

SPECIFICATION OF ERRORS

The Tax Court erred:

1. In holding and deciding that for the taxable year 1945 a portion of the amount paid by Oregon Motor Stages to L. R. Bentson in retirement of all his stock is taxable as a dividend to each of the petitioners Niederkrome, E. Royce, B. Royce,² Jacob, and Schneider.

2. In holding and deciding that for the taxable year 1945 a portion of the incidental disbursements paid by Stages is taxable as a dividend to each of those petitioners.

3. In admitting into evidence respondent's Exhibit A, which includes a copy of the minutes of a meeting of the executive committee of American Business Credit Corporation, a Delaware corporation, held on June 20, 1945, certified by the treasurer and assistant secretary of the corporation. Respondent's Exhibit A is set forth in the Appendix, *infra*, pp. 5a-11a. The admission of this exhibit was objected to on the ground that it was incompetent hearsay. (R. 613-614.)

4. In holding and deciding that for the taxable year 1945 the sum of \$20,000 advanced by Hippodrome Amusement Company to the petitioner E. Royce is taxable to him as a dividend.

5. In holding and deciding that for the taxable years 1944 through 1947 the petitioner E. Royce is taxable with respect to the income of the partnership doing business as Yellow Cab Company in Portland, Oregon, which was distributable to his wife Dora F. Royce.

² One-half of the dividend income charged to B. Royce has been taxed to his wife Isabelle as her share of community income under the laws of Washington. (R. 129-130, 162, 220, 567.)

6. In holding and deciding that for the taxable years 1945 through 1947 the petitioner E. Royce is taxable with respect to the income of the partnership doing business as Yellow Cab Company in Seattle, Washington, which was distributable to his wife Dora F. Royce.

7. In holding and deciding that for the taxable years 1945 through 1947 the petitioner E. Royce is taxable with respect to the income of the partnership doing business as Yellow Cab Company in Seattle, Washington, which was distributable to the trust for the benefit of his daughter Eunice M. Royce.

8. In holding and deciding that for the taxable years 1948 and 1949 the petitioners E. Royce and Dora F. Royce are taxable with respect to the income of the partnership doing business as Yellow Cab Company in Seattle, Washington, which was distributable to the trust for the benefit of their daughter Eunice M. Royce.

9. In that its opinion and decisions are contrary to law and the respondent's regulations.

10. In that its opinion and decisions are not supported by but are contrary to the evidence and its findings of fact.

SUMMARY OF ARGUMENT

These cases present five basic questions for decision.

I.

Stages' distribution of the \$350,000 to Bentson in redemption of his 350 shares was a partial liquidation under section 115(c) of the 1939 Code. The Tax Court, however, has erroneously held that the distribution is taxable under section 115(g) as dividend income to the other stockholders—petitioners Niederkrome, E. Royce, B. Royce, Jacob, and Schneider. This conclusion was reached by wrongly attributing to them the 350 shares which Bentson owned and the \$350,000 which he had borrowed. As a result, the

five petitioners are being very heavily taxed on purely imaginary income.

There is no basis in the record for holding that any of the five petitioners realized income through the redemption of the 350 shares. Indeed, despite its conclusion the Tax Court substantially concedes that those shares belonged to Bentson. In so far as the evidence is concerned, the decision below rests on little more than multiple hearsay contained in respondent's Exhibit A, which refers to E. Royce. The Tax Court committed reversible error in admitting that exhibit into evidence. However, even if the 350 shares are mistakenly attributed to E. Royce on the basis of Exhibit A, the distribution is not taxable to him as a dividend under section 115(g). For if E. Royce is deemed to have owned the 350 shares, the redemption drastically reduced his proportionate interest in the corporation. Section 115(g) does not apply to a redemption which substantially impairs the stockholder's ownership and control.

Aside from its reliance on multiple hearsay, the Tax Court wrongfully regarded the Commissioner's determination as evidence to be balanced against the petitioners' proof. While the Commissioner's determination is initially presumed to be correct, the presumption of correctness promptly disappears when the taxpayer produces contrary evidence. But here the Tax Court erroneously treated the presumption as affirmative evidence to be weighed against the petitioners' proof. Since the court paid excessive deference to the presumption, its decision was improperly reached—quite aside from the other mistakes which contributed to its conclusion.

The Commissioner justified the alleged deficiencies on the ground that Bentson was imported into the various transactions pursuant to an overall plan for a quick redemption of the 350 shares. In the Commissioner's view, which the Tax Court sustained, the five petitioners desired to purchase only the corporate equity represented by 400

shares. The other 350 shares were merely temporarily held and expeditiously redeemed as a means of paying for the balance of the equity which they did not intend to acquire. Even if this untenable view of the evidence is accepted, section 115(g) does not apply. That section does not extend to a redemption of shares which are acquired, not as a permanent investment, but as a transitory expedient pending their quick retirement by the corporation.

The result is the same even apart from the plan alleged by the Commissioner—again erroneously assuming that the 350 shares may be attributed to the petitioners. Section 115(g) is confined to distributions which consist of earnings over and above the investment of the stockholder whose shares are redeemed. Therefore, the section does not apply to a redemption of stock held by an intervening purchaser for value who merely receives the amount which he invested in the stock after the surplus was accumulated. The redemption, then, does not represent a distribution of earnings on an investment. It is only the return of the investment itself. This limiting principle controls here because \$350,000 was paid on the purchase of the 350 shares and the same sum was paid on their redemption. There is no dividend income to be taxed, since only the capital outlay was returned. Any attempt to tax a return of capital as a receipt of income raises a serious constitutional problem.

The Tax Court similarly erred in treating the incidental disbursements paid by Stages as dividend income to the five stockholders other than Bentson. In any event, if the disbursements are regarded as income to them, the same sums are, in turn, deductible by them. In either case no tax is due on the disbursements.

II.

The \$20,000 advanced by Hippodrome to E. Royce is not taxable to him as a dividend. He received the amount as a loan and not for permanent use in lieu of dividends.

All the evidence, written and oral, is uncontradicted. It plainly shows that the advance was approved as a loan and has always been regarded as a loan; that repayment is to be made as soon as the corporation needs the money that the corporation expects to be paid and that E. Royce intends to repay it. The contrary conclusion of the Tax Court is oblivious to the record.

III.

Dora was a member of the Portland partnership, and therefore her share of the profits is not taxable to E. Royce. In holding otherwise the Tax Court failed to follow the relevant principles of law.

The concept of partnership in the income tax law is the same as the concept of partnership in commercial law. In other words, a partnership is an organization for the production of income to which each partner contributes either services or capital. A contribution of capital includes an interest in the firm capital which has been acquired as a gift from another partner. In determining whether a partnership has been formed, the Tax Court cannot appraise the value of the contributed services or capital in the light of some objective standard of its own. If the alleged partner has actually rendered services or actually acquired an interest in the capital, he qualifies as a member of the partnership.

Under these controlling standards of judgment Dora must be recognized as a partner. According to the evidential facts, which are essentially undisputed, Dora acquired a capital interest in the firm and she also rendered services to the firm. E. Royce did not retain any special powers or privileges which rendered her interest illusory. The firm continuously kept books which reflected her capital account, her share of the earnings, her periodic drawings, and the balance to her credit. Whenever distributions were made, she took her aliquot

portion. She spent and invested her income as she saw fit. At the same time, E. Royce continued to pay the ordinary expenses of the household. The Tax Court erred as a matter of law in taxing Dora's share of the firm earnings to E. Royce.

IV.

Dora was also a member of the Seattle partnership, and the Tax Court erred in attributing her share of the firm profits to E. Royce.

Neither Dora nor E. Royce actively participated in the Seattle enterprise. Both were essentially passive investors in a business whose income derived from capital plus the efforts of others. She owned her capital interest as fully as he owned his, and the firm income was no more attributable to him than to her. In such circumstances it is settled that the donee-partner's distributive share of firm earnings is not taxable to the donor-partner.

V.

The trust for Eunice M. Royce was also a member of the Seattle partnership, and the Tax Court equally erred in taxing its distributive share of the income to E. Royce. The trust owned its capital interest in the partnership just as completely as E. Royce owned his. The income of the partnership was not attributable to the personal services of E. Royce, for he was simply an inactive investor in the enterprise. There is no more reason to disregard the trust's interest than his interest. The status of the trust as a partner is not impaired by the powers of administration reserved by E. Royce as trustee. Since he held these powers as trustee, they were fiduciary powers; and fiduciary powers do not disqualify a trust from becoming a partner. Nor may the trust be ignored as a partner because of the loans made to E. Royce. Whether or not the loans constituted sound trust management is at most a question of local trust law. It does not affect the interest of the trust as a partner in the business.

ARGUMENT

I.

**THE DISTRIBUTION IN REDEMPTION OF BENTSON'S STOCK
AND THE INCIDENTAL DISBURSEMENTS ARE NOT
TAXABLE AS DIVIDEND INCOME TO THE OTHER STOCK-
HOLDERS**

The basic issue here is easily stated. Six individuals—Niederkrone, E. Royce, B. Royce, Jacob, Schneider, and Bentson—acquired all the outstanding stock of a corporation. In September, 1945, the corporation paid \$350,000 to Bentson in redemption of his 350 shares. The question is whether the Commissioner may attribute the ownership of the 350 shares to the other stockholders, and then tax the \$350,000 to them as dividend income. In other words, may the Government impose heavy income taxes on the basis of stock which was never owned and income which was never received?

Our analysis begins with the Internal Revenue Code of 1939, for any tax “asserted by the Commissioner” must be “authorized by Congress.” *Helvering v. Griffiths*, 318 U. S. 371, 394 (1943). Section 115(c) of the 1939 Code declares that “amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock.” Section 115(i) defines “amounts distributed in partial liquidation” as including “a distribution by a corporation in complete cancellation or redemption of a part of its stock.” Finally, section 115(g) states that if a corporation cancels or redeems its stock “at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend,” the distributed amount “shall be treated as a taxable dividend” to the extent that it represents a distribution of accumulated earnings or profits. In short, the quoted statutes provide a general rule and a special exception. Under the general rule the proceeds of a redemption of stock are treated as the proceeds of

a sale, and any gain is taxable as a capital gain. Under the special exception the proceeds of redemption are taxed as ordinary income if the distribution is “essentially equivalent” to a dividend.

It is equally settled that a distribution may be in “partial liquidation” though the corporation is not in the process of contraction or dissolution. As the Tax Court has succinctly stated, section 115 (c) and (i) “applies, not to a distribution in liquidation of the corporation or its *business*, but to a distribution in cancellation or redemption of a part of its *stock*.” *Hamilton Allport*, 4 T. C. 401, 403 (1944). (Italics in original.) And a “partial liquidation” occurs “whenever a corporation distributes money or assets in complete cancellation or redemption of a part of its capital stock. No particular portion is mentioned, nor is the word ‘part’ in any way limited.” *Salt Lake Hardware Co.*, 27 B.T.A. 482, 486 (1932). “In order for a distribution to be a distribution in partial liquidation it is not necessary that the corporation be planning a cessation or winding up of a part of its business activities.” *L. B. Coley*, 45 B.T.A. 405, 416 (1941). See also *Benjamin R. Britt*, 40 B.T.A. 790, 796-797 (1939), *aff’d on other issues*, 114 F.2d 10 (4th Cir. 1940). The regulations are to the same effect. They expressly recognize a “partial liquidation” through a “complete retirement of any part of the stock, whether or not pro rata among the shareholders.” Regulations 111, § 29.115-5. It is immaterial that the corporation continues to function as before. Indeed, the statute and regulations assume that the corporation will remain alive and active, for they both direct that the distribution be appropriately allocated between its capital account and earned surplus in order to determine the tax on later distributions. See Int. Rev. Code of 1939, § 115(c); Regulations 111, § 29.115-5.

In view of the rules just summarized the redemption of the 350 shares readily qualified as a “partial liquidation”

within section 115(c). The distribution of the \$350,000 was "in complete cancellation" of all those shares. And, in accordance with section 115(c) and the related regulations, \$35,000 was charged to capital and \$315,000 to surplus. Section 115(g) cannot apply because the redemption completely terminated Bentson's interest in Stages. In the words of the Treasury, "a cancellation or redemption by a corporation of all of the stock of a particular shareholder, so that the shareholder ceases to be interested in the affairs of the corporation, does not effect a distribution of a taxable dividend." Regulations 111, § 29.115-9. Accord: *Zenz v. Quinlivan*, 213 F. 2d 914 (6th Cir. 1954); *Summerfield v. United States*, 145 F. Supp. 104 (E.D. Mich. 1956), *aff'd*, 249 F. 2d 446 (6th Cir. 1957); *Clara Louise Flinn*, 37 B.T.A. 1085 (1938); *Carter Tiffany*, 16 T. C. 1443 (1951), *petition dismissed*, 2d Cir., March 7, 1952; *Auto Finance Co.*, 24 T. C. 416 (1955), *aff'd*, 229 F. 2d 318 (4th Cir. 1956); *Giles E. Bullock*, 26 T. C. 276 (1956); *Jackson Howell*, 26 T. C. 846 (1956); *Estate of Ira F. Searle*, 9 T.C.M. 957 (1950); and see *In re Lukens' Estate*, 246 F. 2d 403, 406 (3d Cir. 1957). Cf. Rev. Rul. 56-556, 1956-2 Cum. Bull. 177; Rev. Rul. 57-387, I.R.B. 1957-35, 12.

Despite the pertinent rules of law the Commissioner asserts that the \$350,000 is taxable as dividend income under section 115(g). He has avoided the relevant rules by simply refusing to regard Bentson as a stockholder of Stages. The Commissioner contends that petitioners Niederkrome, E. Royce, B. Royce, Jacob, and Schneider "purchased the Stages stock with the funds which they in substance borrowed from ABC, which funds were later repaid with those obtained from Stages; that the indebtedness was incurred by and for the petitioners; and that its payment by the corporation constituted a dividend to them." In the light of this analysis the Commissioner would "ignore the presence of Bentson in the transactions as being no more than a straw man." (R. 237.) And so,

in order to sustain his deficiencies, the Commissioner has zealously enveloped the other five stockholders in a conspiratorial atmosphere of sham and deception. According to the Commissioner, the five stockholders disingenuously planned a quick redemption of the 350 shares after their acquisition, and Bentson was calculatedly imported into the transactions as a means of disguising a taxable dividend within section 115(g).

We cannot do better than quote the precise words of the Commissioner's accusation as they appear in his notices of deficiency. The five petitioners, the Commissioner says, "negotiated for the capital stock of" Stages. "As a result of the negotiations" they purchased 400 shares. "In accordance with the plan adopted, the remaining 350 shares of" Stages "were acquired in the name of" Bentson "in consideration of payment of \$350,000.00 in cash. Such payment was made from the proceeds of a loan obtained by" E. Royce, "acting for" himself and his four "associates," through ABC-Portland, "on a 90-day note which was signed by" E. Royce and Bentson, "and which was collateralized by deposit of the entire 750 shares of stock" of Stages. "On or about September 6, 1945, pursuant to the plan adopted by" the five "associates," Stages "acquired the 350 shares of its own stock then standing in the name of" Bentson "and issued its check to him in the sum of \$350,000.00. This check was immediately endorsed and delivered to" ABC-Portland "in satisfaction of the 90-day note signed by" E. Royce and Bentson. "It has been determined that it was not intended that" Bentson "should acquire, nor did he at any time acquire, any bona fide or actual beneficial interest in the stock of" Stages. (R. 25-26, 88-89, 128-129, 188-189, 201-202.)

While the Commissioner is firmly persuaded that the redemption derived from a prearranged "plan," he is considerably less assured in finding someone to tax on the alleged dividend income. The doubts which have dis-

turbed the Commissioner are fully revealed in his notices of deficiency. For in these notices he has made diverse determinations that are clearly in conflict. On the one hand, he has ruled that Niederkrome, B. Royce, Jacob, and Schneider are each taxable on a portion of the \$350,000. The portion taxed to each of the four is determined by the ratio of his number of shares "to the total of 400 shares." (R. 26, 129, 189, 202.) On the other hand, the Commissioner has also ruled that E. Royce is taxable on the entire \$350,000. (R. 89.) Though the determinations are irreconcilable, they have one thing in common. Each proceeds on the assumption that Bentson was a pawn in a devious scheme looking toward a quick redemption—that he neither owned the shares that were redeemed nor borrowed the money that was repaid.

The Tax Court has resolved the Commissioner's difficulties by holding that the \$350,000 paid to Bentson is taxable as dividend income to all five petitioners on a pro rata basis. We respectfully submit that the Tax Court's decision is clearly wrong. The alleged artful plot derives entirely from the Commissioner's own resourceful imagination. The voluminous record does not disclose what he has diligently discovered. In treating Bentson as a mere pawn in a "plan," the Tax Court has plainly failed to abide by the evidence and the governing principles of law. Indeed, its decision rests on little more than one item of multiple hearsay, plus an erroneous assumption that the Commissioner's initial determination qualifies as evidence.

For convenience of analysis we shall first examine the relevant evidence in regard to Niederkrome, B. Royce, Jacob, and Schneider. We shall then appraise the relevant evidence with respect to E. Royce.

A. Niederkrome, B. Royce, Jacob, and Schneider Did Not Realize Any Income Through the Redemption

There is not the slightest proof in the lengthy record that Niederkrome, B. Royce, Jacob, or Schneider owned any of the 350 shares redeemed from Bentson or borrowed any of the \$350,000 loaned by ABC-Portland. On the contrary, the Government's own evidence reveals that it has freely indulged in conjecture and speculation on behalf of the result which it seeks.

Niederkrome, B. Royce, Jacob, and Schneider each took the stand, and the testimony of all four was specific and to the point. Niederkrome declared that he owned only 55 shares (R. 348, 351-352); that he had no interest in the 350 shares acquired by Bentson (R. 350-351); and that he did not participate in the negotiations for the loan from ABC-Portland. (R. 357.) B. Royce similarly stated that he had no interest in the 350 shares (R. 563-564); and that he was wholly removed from the negotiations for the loan. (R. 567.)

Jacob has been an attorney for about 30 years. (R. 315.) He testified that he acquired 100 shares (R. 316, 335); that Bentson was one of the purchasing group (R. 315); that the 350 shares belonged to Bentson (R. 316-318, 330-331, 333-334); that the other five purchasers "expected and wanted to buy only" 400 shares (R. 316, 345); and that there was no design or understanding to retire the 350 shares "shortly." (R. 342.) Jacob further stated that Bentson was "very definitely" informed of Stages' earnings record before acquiring the 350 shares. (R. 328.) Bentson "camped on Mr. Schneider's trail here for several days, in connection with the operation before he went into it." Bentson "was with Mr. Schneider for quite some time before he decided finally to go into it." (R. 328.) Bentson was "active" in the transaction "right down to the day of the transfer of the stock" (R. 338); he "sat up and took part in all the negotiations" (R. 339); and he

attended the closing. (R. 322.) He "made a very good appearance" and was "very impressive looking" (R. 317, 339); he was "very intelligent and alert" (R. 317, 339); and at one meeting "he made the most impressive presentation of anybody there." (R. 339.) In regard to the loan from ABC-Portland, Jacob testified that he merely introduced Bentson and E. Royce to Davidson. (R. 318, 336, 338, 343.) Jacob had previously met Davidson in seeking "some financing" from ABC-Portland "for some other clients." (R. 318.) After the introduction all negotiations leading to the loan were handled by Bentson and E. Royce. (R. 318-319.) Jacob had nothing to do with the negotiations (R. 318-319, 336, 341-343), nor was he present when the note for \$350,000 was signed. (R. 325, 327.)

Schneider confirmed the evidence given by the others. He emphasized that Bentson owned the 350 shares. (R. 369, 372-374.) He explained that before the purchase was consummated, he and Bentson inspected the bus routes "over a period of two and a half days." (R. 364.) And he meticulously summarized their tour of inspection, which included "every depot." (R. 364-365.) Bentson "was very much interested in the facilities of the Oregon Motor Stages;" "very much interested in the Camp Adair installation, and he went through the shop of the Oregon Motor Stages, at that time, we had a shop in Astoria, we had one in Forest Grove, and we had a shop in Corvallis, and we had a shop in Salem, and he also checked the facilities of the operation in Portland." (R. 365.) Apart from all this checking, Bentson spent several hours with the comptroller of the company and went over its financial statements. (R. 365-366.) Bentson was present throughout the closing and took "the same part as anybody else did." (R. 367, 373.)

Despite all this plain-spoken testimony the Tax Court sustained the Commissioner. We now turn to the reasons given by the court in failing to heed the evidence.

The Tax Court first notes the absence of any proof that in July, 1945, Bentson "had a net worth ample to undertake the purchase of stock" for \$350,000, or that he was then "a man of wealth." (R. 239.)³ The Tax Court then observes that the purchase of the 350 shares was not recorded in the rather crude books which Bentson kept. (R. 240.) We fail to see how these matters remotely indicate that Niederkrome, B. Royce, Jacob, and Schneider owned any of the 350 shares or owed any of the \$350,000. Investors commonly embark on financial ventures with borrowed funds. What Bentson did is customarily done every day in our economy of private enterprise. The entrepreneur who uses borrowed capital is a familiar figure in the world of business. And in "a free economy, courts are not permitted to make contracts for the parties, but merely to pass upon the legality of such contracts when made." *Nelson v. Commissioner*, 203 F. 2d 1, 7 (6th Cir. 1953). Surely it is odd reasoning that regards a routine mode of investment as a cause for suspicion, and then treats undue suspicion as an adequate excuse for attributing the acquired property to persons other than the investor. No one disputes that Bentson lacked sufficient funds of his own to purchase the 350 shares.⁴ Otherwise he would not have resorted to the loan.⁵ The question, rather, is whether his need for financial assistance is any proof that it was others who made the loan and bought the shares. Nor does the Tax Court reach firmer ground when it refers briefly to Bentson's homespun rec-

³ At this point the Tax Court gratuitously adds a sinister touch with the comment that Bentson refused "to render a net worth statement to an agent of respondent when called upon to do so during the course of his investigation." (R. 239-240.) The agent merely indicated that Bentson did not itemize his various assets when informally asked to do so. (R. 608.) In the Tax Court even the Commissioner regarded this trivial detail as too irrelevant to mention in his brief.

⁴ See p. 5, *supra*.

⁵ The Tax Court concedes that Bentson's funds "were blocked in Canada." (R. 239.) See also R. 319, 340, 373, 378, 391, 407.

ords found after his death. In the first place, the court freely assumes, without any supporting evidence, that Bentson methodically entered each and every financial transaction as it occurred.⁶ Second, and more important, Bentson's books or lack of books can scarcely be dignified as evidence with respect to Niederkrome, B. Royce, Jacob, and Schneider.

The Tax Court next concedes that there is evidence "that Bentson applied for and was granted a loan of \$350,000 by ABC to provide him with cash to make the purchase." (R. 240.) However, the court then promptly adds that "other evidence, which we regard as much more reliable, is to the contrary. Respondent's view is that E. Royce, acting on behalf of petitioners, applied for and negotiated the loan." (R. 240.) The opinion proceeds to indicate that the so-called "other" and "much more reliable" evidence consists of minutes of a meeting allegedly held by the executive committee of American Business Credit Corporation, hereinafter referred to as ABC-Delaware, which was the parent company of ABC-Portland. (R. 240.) "Bentson," the Tax Court says, "was not mentioned in the corporate record of ABC and nothing in the minutes of the meeting indicates that Bentson ever applied for the loan or had anything to do with it. Clearly, the loan was made to E. Royce." (R. 240.) Having made these observations the court nevertheless feels compelled to admit that Bentson signed the note as a maker. But having made this admission, the court immediately tries to bypass it as follows: "Bentson's signature on the note was not required by the executive committee in granting the loan and no proof was made of subsequent action

⁶ The Tax Court states that Bentson "was careful to record many small transactions in books personally kept by him." (R. 240.) Here the court is merely engaging in guesswork. The record contains no proof as to how "careful" Bentson was. The Commissioner's own witness conceded that "there could have been other records, and there could have been assets not reflected there." (R. 608-609.) Bentson may very well have had separate records for his 350 shares.

to include him as a borrower. Thus, absent proof of any requirement by the lender that Bentson sign the note as a co-maker, he would appear to have been a mere volunteer." (R. 240-241.)

Once more the Tax Court's appraisal is less than responsive to the evidence. In fact, the supposed proof cited by the court confirms what the evidence otherwise discloses—that Niederkrome, B. Royce, Jacob, and Schneider did not seek or receive any loan from ABC-Portland. The Tax Court's effort to rationalize differently rests entirely on certain minutes of ABC-Delaware. As we shall shortly show, these minutes are simply inadmissible hearsay which the Tax Court regards as significant evidence. See pp. 44-57, *infra*. However, even if this error is ignored, the conclusion remains the same. The minutes nowhere suggest or imply that Niederkrome, B. Royce, Jacob, or Schneider applied for a loan. At most the "other" and "much more reliable" evidence refers to a loan supposedly sought by E. Royce. Certainly mere evidence that E. Royce may have applied for a loan⁷ does not qualify as proof that he acted as agent for Niederkrome, B. Royce, Jacob, or Schneider. Moreover, the Tax Court is wholly oblivious to cogent documentary evidence when it declares that "Bentson was not mentioned in the corporate record of ABC" and "no proof was made of subsequent action to include him as a borrower." We are referring to the financial records of ABC-Portland which the Commissioner himself introduced and which the Tax Court nowhere mentions. (Ex. D, E, G.). These routine business records unmistakably disclose an indebtedness of \$350,000 owed by Bentson to ABC-Portland. See pp. 6-7, *supra*.

Three conclusions easily emerge here. First, the fact that Bentson is not mentioned in the minutes is no proof whatever that anyone applied for a loan on behalf of Nieder-

⁷ At this point we are, of course, erroneously assuming, as the Tax Court held, that the minutes of ABC-Delaware were admissible as evidence.

krome, B. Royce, Jacob, or Schneider. For that matter, neither is Niederkrome or Schneider mentioned in the minutes. Second, the minutes do not in any way indicate that Bentson or anyone else was serving as a compliant conduit for them. Third, the Commissioner's own documentary evidence reinforces the taxpayers' specific testimony that Bentson applied for and obtained a loan of \$350,000 from ABC-Portland.

The Tax Court's reasoning does not improve as it continues. The "evidence convinces us," says the court, "that Bentson did not become involved in the transaction until after application was made for the loan by Royce." (R. 241.) "According to the testimony," the court states, "Bentson became interested as a participant in the venture during a visit to Portland in June 1945 and, after an examination of Stages' financial condition and its assets located in various cities, agreed to buy the uncommitted 350 shares." (R. 241.) Having correctly summarized the testimony—which is nowhere contradicted—the Tax Court then brushes it aside because "proof is lacking" that Bentson "was in Portland before application was made to ABC for the loan." (R. 241.) "Without more evidence," the court states, "we cannot find" that Bentson initially met with Jacob and Schneider, at E. Royce's home, "earlier than the Sunday during the latter part of June 1945. The last Sunday in June fell on the 24th, which was 4 days after the loan application was considered by the executive committee of the parent company" of ABC-Portland. "Clearly, Bentson, on such facts, could not have signed the application for the loan." (R. 242.)

Here the Tax Court has too readily become entangled in a difficulty of its own making. There is ample, undisputed evidence that Bentson was in Portland before June 20, 1945. On direct examination attorney Jacob testified that he met with Bentson at E. Royce's home "during the middle or latter part of June, 1945." (R. 317.) On cross-examination Jacob stated that Bentson became

interested in the stock negotiations in "the latter part of June." Since ten years had elapsed, Jacob understandably could not remember the precise date, but he definitely recalled that he conferred with Bentson at E. Royce's house on "a Sunday evening," and that "it was some time in the latter part of June." (R. 338.) Jacob further stated that he introduced Bentson to Davidson "some time the latter part of June"—"between the 15th and the end of the month." (R. 338.) Schneider testified that he and Jacob met Bentson together at E. Royce's home (R. 363), and that Bentson inspected the bus routes and facilities "perhaps a couple of weeks before" the purchase was made. (R. 380-381.)

On a fair reading of the testimony Bentson was in Portland in the "middle or latter part" of June, 1945. In June, 1945, Sunday fell on the 3rd, 10th, 17th and 24th. The "middle" portion of June would, of course, embrace the 10th. However, even if we assume, in behalf of the Commissioner, that the meeting with Bentson was not until the "latter part" of June, 1945, it could still have easily occurred before June 20th. The "latter part" of a month, as normally understood, is the entire second half of the month. Hence here the second half of June necessarily included the Sunday which fell on the 17th, or three days before the asserted meeting of the executive committee of ABC-Delaware. To this we should add Jacob's positive testimony that he introduced Bentson to Davidson before the negotiations for the loan began. See p. 34, *supra*. Finally, the Tax Court itself found that Bentson "visited Portland and was consulted about the venture." (R. 222.)

As a further basis for disregarding the evidence, the Tax Court next reasons that "the circumstances are such as to create an inference" that E. Royce "obtained the loan for the benefit of all of the petitioners." (R. 242.) In support of this "inference" the court states that "petitioners did not wish to invest more than \$400,000 of their

own money in the stock. Borrowing became either necessary or desirable to acquire the remaining 350 shares, and to obtain a loan, a pledge of all of the stock as security for the loan was required. All of the interested parties agreed to loan their stock for that purpose and it was put up as collateral for payment of the note evidencing the loan concurrently with its acquisition from the sellers. E. Royce thus assumed, as co-maker, primary liability for payment of the note and the other stockholders were liable to the extent of the value of their pledged stock. All benefited by the loan for only with it, was all of the stock acquired.” (R. 242.)

The Tax Court’s analysis merely begs the question to be answered. Of course, Niederkrome, Jacob, Schneider, and the Royces “did not wish to invest more than \$400,000 of their own money in the stock.” But it does not in the least follow that they, rather than Bentson, therefore purchased the other 350 shares. The answer turns on a balanced appraisal of the evidence, as distinguished from “inferences” which stubbornly ignore the evidence. And according to the evidence, Niederkrome, B. Royce, Jacob, and Schneider did not participate in the purchase of the 350 shares or the loan of the \$350,000. See pp. 33-34, *supra*. The Tax Court indulges in further question-begging when it dwells on the “benefit” derived from the loan. The alleged “benefit” simply presupposes once more that Bentson did not buy the 350 shares with borrowed funds, secured by his own shares as well as the shares loaned by the others. Nor does the Tax Court move much further when it remarks that the others pledged their stock as collateral for the loan from ABC-Portland. As Niederkrome, B. Royce, Jacob, and Schneider very clearly testified, they each pledged their individual shares because ABC-Portland required them to do so. Nothing in the record contradicts their firm assertion that their shares were put up as collateral for the loan of Bentson, and not for any loan of their own. See pp. 5-6, *supra*.

The Tax Court's decision in *Ray Edenfield*, 19 T.C. 13 (1952), leaves little more to be said. There the taxpayer and two others purchased part of the stock of a corporation. At the same time the sellers turned in the rest of their stock to the corporation for second mortgage notes payable in installments. The taxpayer and his associates pledged their stock as security for the corporate indebtedness. Later, when the corporation paid the notes, the Commissioner contended that a portion of the payments was dividend income to the taxpayer. The Tax Court quickly disposed of his argument. It pointed out that the corporation, and not the acquiring stockholders, was the debtor on the notes. "Under such state of facts it requires no citation of authorities to establish that payments on the debt did not result in dividends" to the taxpayer. He "did not at any time purchase or own the stock which was retired. The stock was never transferred to him and he never assumed any personal liability for the mortgage." While he and his associates pledged their own shares as additional security, "that was merely giving the corporation of which they were then the sole stockholders the benefit of the use of their collateral. The mortgage indebtedness was in no sense their indebtedness. It was the corporation's indebtedness." *Id.* at 20-21. The Commission has formally acquiesced in the *Edenfield* opinion as a correct analysis to be applied "in the disposition of other cases." See 1953-1 Cum. Bull. 2, 4. Cf. *Estate of Edward L. Koepenick*, 2 T.C.M. 143 (1943).

The *Edenfield* case and this case are practically the same. There a group of stockholders pledged their newly acquired shares as collateral for the indebtedness of their corporation. Here a group of stockholders pledged their newly acquired shares as collateral for the indebtedness of an associate. In both cases the payment of the loan derived from corporate funds, and the pledgors "did not at any time purchase or own the stock which was retired." In brief, those who loaned their shares as collateral here

no more "benefited" than those who did likewise in the *Edenfield* case. And the resulting release of their stock from the pledge on behalf of Bentson did not bestow on them any gains or profits. They merely reacquired possession of the stock which they already owned. For analogous cases where the Commissioner tried in vain to construct dividend income out of corporate payments to others, see *Ruben v. Commissioner*, 97 F. 2d 926 (8th Cir. 1938); *Nelson v. Commissioner*, *supra*; *Tucker v. Commissioner*, 226 F. 2d 177 (8th Cir. 1955); *S. K. Ames, Inc.*, 46 B.T.A. 1020 (1942); *Lloyd H. Diehl*, 1 T.C. 139 (1942), *aff'd*, 142 F. 2d 449 (6th Cir. 1944).

As a last reason for rejecting the relevant testimony, the Tax Court states, "We search in vain for a justifiable corporate business reason for redeeming the stock. The redemption served to make available funds from surplus with which to pay the outstanding note and put petitioners in a position to repossess their stock free of any encumbrance." (R. 243.) After indicating that the redemption reduced the funds available for new equipment, the court declares, "In any event, we find no justification for concluding under the evidence that the redemption in question served a legitimate business purpose of Stages." (R. 244.)

Again the Tax Court seems strangely confused in response to the question before it. Since the redemption of the 350 shares completely terminated Bentson's interest in the corporation, the distribution of the \$350,000 cannot be taxed as a dividend under section 115(g). See p. 30, *supra*. The presence or absence of business purpose is wholly irrelevant where all the shares of a particular stockholder are redeemed. See *In re Lukens' Estate*, *supra*, at 406; and *Zenz v. Quinlivan*, *supra*, where the redemption was solely designed to serve an individual tax advantage and absorbed substantially the entire earned surplus. As the Second Circuit recently emphasized in regard to business purpose, "We find nothing in the text

of the statute, its legislative history, or the applicable Treasury Regulations that makes this consideration relevant." *Northup v. United States*, 240 F. 2d 304, 307 (2d Cir. 1957).

Finally, despite all its labored analysis the Tax Court substantially agrees that the 350 shares belonged to Bentson. The court refers to "petitioners and Bentson's acquisition of Stages stock." (R. 234.) It finds that "Bentson was one of the stockholders present at the meeting" which considered the redemption of the 350 shares. (R. 229.) And later it significantly states, "The retirement of about 47 percent of the outstanding stock gave petitioners, collectively, complete ownership of Stages and increased their proportional interests in the remaining assets and future earnings without any additional investment on their part." (R. 243.) This observation is intelligible only if Bentson previously owned the 350 shares. If, as the Commissioner asserts, Bentson was merely the straw of his associates and they already owned all the shares of Stages, then obviously the redemption could not have given them "complete ownership of Stages and increased their proportional interests" in the assets and earnings. Hence in the end the Tax Court, too, regards Bentson as the owner of the 350 shares. And since he owned those shares, the amount paid to him on their redemption cannot be taxed to others as a dividend under section 115(g). See pp. 29-30, *supra*.

B. E. Royce Did Not Realize Any Income Through the Redemption

We have argued that the record is devoid of any evidence which justifies the deficiencies asserted against Niederkrome, B. Royce, Jacob, and Schneider. On the contrary, the evidence affirmatively reveals that the deficiencies were conceived in error. We now examine the evidence as it relates to E. Royce.

E. Royce testified at length concerning the 350 shares. He stated that he had no interest in them and that they

belonged to Bentson. (R. 393, 397-398.) Before Bentson acquired them, he "investigated this pretty thoroughly, and he thought it was a good business deal." (R. 391.) As regards the loan, E. Royce explained that Jacob introduced him and Bentson to Davidson; that "until I met Mr. Davidson through Mr. Jacob," ABC-Portland "was brand new to me;" and that Bentson then applied for a loan from ABC-Portland. (R. 391, 393, 404.) Bentson was "the active negotiator for the loan," "dealt with" Davidson, and "made the arrangements for the loan." (R. 403-404.) In granting the loan ABC-Portland required E. Royce to sign the note as accommodation maker because Bentson was a Canadian citizen. (R. 391-392, 404.) ABC-Portland distinctly understood that E. Royce was a party to the note on an accommodation basis. (R. 391-392, 396-397, 404-405.) At no time did he represent that he was making a loan on his own behalf. (R. 403-404.) And he never "at any time, in any way," indicated to ABC-Portland that the loan was for his "benefit." (R. 396.) Moreover, there was no understanding that the 350 shares would be redeemed later. (R. 406.) So far as E. Royce was aware, Bentson had intended to hold on to his stock. (R. 408-409.) E. Royce did not see the check that Stages issued on the redemption of the 350 shares. (R. 395-396, 412.)

The Tax Court turned its back on E. Royce's testimony, just as it chose to disregard the testimony of Niederkrome, B. Royce, Jacob, and Schneider. We have already examined the Tax Court's efforts to justify its departure from the ample evidence before it. See pp. 34-43. *supra*. At this point only one other item remains to be considered. This item is the Commissioner's Exhibit A, which was referred to in the Stipulation of Facts. (R. 209-210.) The petitioners expressly reserved the right to object to Exhibit A when offered as evidence. (R. 213-214.)

1. The Tax Court Erred in Admitting Exhibit A

Exhibit A consists of an affidavit by one Stuart A. Wixson and three attached typewritten pages. The affidavit is dated April 21, 1955. It states that Wixson is treasurer and assistant secretary of Crown Finance Company, Inc., formerly ABC-Delaware; that the three attached pages are a copy of the minutes of a meeting held on June 20, 1945, by the executive committee of ABC-Delaware; that "as appears" from the minutes, ABC-Delaware "approved the loan" of \$350,000 "by its Oregon subsidiary;" that "under the method of operation" between the two companies, the parent "would advance" to the subsidiary funds required "for the transaction of its business;" that the subsidiary "was dissolved" on or about June 27, 1949; and that "certain of its records were transferred" to the parent and were in the affiant's "general custody."

The three attached pages purportedly record a meeting of the executive committee of ABC-Delaware on June 20, 1945. The persons listed as present are "Messrs. Burman, Cashmore and Kincaid of the Committee; and by invitation, Messrs. Dick and Ebe, Vice Presidents of the Corporation, and Mr. Davidson, Vice President of the Corporation's Portland, Oregon subsidiary." Kincaid "served as Chairman" and a Mr. Fitzgerald "acted as Secretary." The minutes indicate that the committee considered four separate financial matters, including a requested loan of \$350,000. In the latter connection Davidson and Ebe "submitted an application on behalf of ABC-Portland. A group of outstanding individuals in Portland, headed by Messrs. Barney & Roy Royce and Robert Jacob, desire to purchase the entire capital stock of Oregon Motor Stages, largest intra-state bus company operating in Oregon." Of the total shares outstanding, the "purchasers intend to buy 400 shares for \$400,000, with their own funds. They ask that we extend a line of credit of \$350,000, the balance of the purchase price of the

Oregon Motor Stages stock. We are asked to lend Mr. Roy Royce, personally, the sum of \$350,000, on his note, to be secured by all of the capital stock of Oregon Motor Stages. Our loan to be repaid in 90 days or adjusted as conditions warrant. Mr. R. Royce's personal statement reflects a net worth of \$1,366,000.00. Retiring stockholders will guarantee to R. Royce and his associates that the worth of Oregon Motor Stages is not less than the figure shown on the company's 4/30/45 statement. A fee of \$5,000 plus 5% per annum on cash for every 90 days is charge contemplated." The minutes then go on to say that the executive committee "reviewed in detail the financial condition" of Stages; that "Mr. Davidson was questioned in respect to the proposed transaction;" and that "Mr. Dick's opinion was received. After consideration and full review, the Committee unanimously approved the credit line requested, subject to approval of counsel" and "unanimous approval of full Portland Committee." The minutes are purportedly signed by Fitzgerald, as Acting Secretary.

The petitioners objected to the admission of Exhibit A on the ground that it was "purely hearsay." (R. 613-614.) The Tax Court overruled the objection. (R. 615.) We have already pointed out that Exhibit A proves nothing in regard to Niederkrome, B. Royce, Jacob, and Schneider. See pp. 36-38, *supra*. As we shall now indicate, Exhibit A also proves nothing as against E. Royce.

The Tax Court hears and decides cases within the rules of evidence which apply in the District of Columbia. Int. Rev. Code of 1954, § 7453; Int. Rev. Code of 1939, § 1111. See *Baldwin v. Commissioner*, 125 F. 2d 812, 814 (9th Cir. 1942); *Masters v. Commissioner*, 243 F. 2d 335, 338 (3d Cir. 1957). Hence the Commissioner, no less than taxpayers, is barred from resorting to mere hearsay as legal proof. *Parish's Estate v. Commissioner*, 187 F. 2d 390 (7th Cir. 1951). See also *Spiegel's Housefurnishing Co.*, 2 B.T.A. 158 (1925); *Walker Creamery*

Products Co., 2 B.T.A. 474 (1925); *The Daily News Publishing Co.*, 4 B.T.A. 31 (1926); *Harry Symons*, 11 B.T.A. 886 (1928). Obviously, the minutes in Exhibit A were bare hearsay with respect to E. Royce and the other petitioners. A corporation's books and records "are not competent evidence against third persons to prove contracts with them, in the absence of proof that they knew and assented thereto." *Oregon & C. R. Co. v. Grubissich*, 206 Fed. 577, 580 (9th Cir. 1913). See also *Harrison v. Remington Paper Co.*, 140 Fed. 385, 401-402 (8th Cir. 1905), *cert. denied*, 199 U. S. 607 (1905); *Branding Iron Club v. Riggs*, 207 F. 2d 720, 725 (10th Cir. 1953). The Commissioner made no attempt to offer any such proof of knowledge or assent. "There is no evidence" that any of the petitioners "was present at the meeting or knew of its action." *Branding Iron Club v. Riggs*, *supra*, at 725.

Of course, we are not unaware of various exceptions to the rule against hearsay. For present purposes, it seems, we need only consider the exception relating to business entries. Cf. *Bruce v. McClure*, 220 F. 2d 330, 335 (5th Cir. 1955). In the Tax Court, as in the District Court of the District of Columbia, business entries are admissible under the Federal Business Records Act. Act of June 25, 1948, 62 Stat. 945, 28 U.S.C. § 1732. This statute provides that "any writing or record, whether in the form of an entry in a book or otherwise, made as a memorandum or record of any act, transaction, occurrence, or event," is "admissible as evidence of such act, transaction, occurrence, or event, if made in the regular course of any business, and if it was the regular course of such business to make such memorandum or record at the time of such act, transaction, occurrence, or event or within a reasonable time thereafter."⁸

⁸ The statute further provides: "All other circumstances of the making of such writing or record, including lack of personal knowledge by the entrant or maker, may be shown to affect its weight, but such circumstances shall not affect its admissibility."

At common law business entries were not admissible unless they were authenticated by the very persons who made them. See, e.g., *Nettles v. Tillson*, 87 F. 2d 770 (5th Cir. 1937). The Business Records Act was designed to remove this unduly restrictive limitation. See *Palmer v. Hoffman*, 318 U. S. 109, 112 (1943); *Schmeller v. United States*, 143 F. 2d 544, 550 (6th Cir. 1944); *Hartzog v. United States*, 217 F. 2d 706, 710 (4th Cir. 1954); *United States v. Indian Trailer Corp.*, 226 F. 2d 595, 600 (7th Cir. 1955). While the governing rule has been relaxed, records are still inadmissible unless their proponent has first laid a proper foundation for their reception. In the concise words of Judge Learned Hand, corporate books "are not competent against a stranger merely because they are the books of the company whose dealings they purport to record." Nor do they become competent because the other party admits that they are books of the corporation. That alone does not make them admissible. *United States v. Feinberg*, 140 F. 2d 592, 596 (2d Cir. 1944). See also *Masterson v. Pennsylvania R. Co.*, 182 F. 2d 793, 797 (3d Cir. 1950).⁹ As the statute itself patently requires, there must first be proof that the record was made in the regular course of the business, and that it was the regular course of the business to make the record at the time of the recorded transaction or within a reasonable time after the transaction. If no such evidence is given, the writing is rigorously excluded. *United States v. Feinberg, supra*; *Clainos v. United States*, 163 F. 2d 593 (D.C. Cir. 1947); *Bruce v. McClure, supra*; *Schering Corp. v. Marzall*, 101 F. Supp. 571 (D.D.C. 1951); *United States v. Skolnik*, 149 F. Supp. 703 (S.D.N.Y. 1957); see *United States v. Bartholomew*, 137 F. Supp. 700, 708 (W.D. Ark. 1956).

⁹ See further *Terminal Railroad Association*, 17 B.T.A. 1135, 1164 (1929), where the taxpayer stipulated the existence of certain entries but reserved the right to object to their admission. In any event, a stipulation with respect to certain records is not a concession that the records are correct. *Azevedo v. Commissioner*, 246 F. 2d 196, 198 (9th Cir. 1957).

Here the Commissioner refrained from any effort to provide a proper foundation. The only evidence which the Commissioner produced was the affidavit by Wixson; and the only information which Wixson supplied was a copy of certain minutes within his custody as of April 21, 1955—ten years after the stated meeting of the executive committee. Neither Wixson nor anyone else offered the least proof that the minutes were made in the regular course of ABC-Delaware's business, or that it was the regular course of the business to prepare such minutes within a reasonable interval after the recorded meeting. At most the Commissioner merely established that the stated minutes were found among the corporate papers. Apparently Wixson "knew nothing else" about the writing, "and no other witness testified as to its authenticity." Cf. *Bruce v. McClure, supra*, at 334. As the Court of Appeals for the District of Columbia has emphasized, this is precisely the kind of meager evidence which is no basis whatever for admitting business records. *Clainos v. United States, supra*, at 595. If Wixson had taken the stand and simply stated what appears in his affidavit, the three pages would clearly have been inadmissible. Cf. *Spiegel's Housefurnishing Co., supra*, at 159. The same three pages did not become any more admissible because Wixson made the same inadequate observation in an affidavit rather than in court.

We are only repeating the conclusion reached amid similar circumstances in *Schering Corp. v. Marzall, supra*.¹⁰ There, too, a litigant sought to introduce books without the necessary foundation. The books "were not identified by the person who made the entries, or by any person who saw these books contemporaneously with the

¹⁰ Under section 7453 of the 1954 Code the decisions in the District of Columbia are especially important on questions of evidence from the Tax Court. As this Court has stated, "we therefore look to decisions of the Courts of that District to resolve" such questions. *Baldwin v. Commissioner, supra*, at 814.

events" which they purported "to record." They were merely "identified by witnesses who said they first saw them" about ten years after the events described. "There was no proof" that the books "were contemporaneous records and were not made subsequently to the events" which they professed "to report." In view of this failure of proof the books were naturally excluded.¹¹ See further *Bruce v. McClure*, *supra*; *United States v. Indian Trailer Corp.*, *supra*, at 600, excluding a record prepared a month after the alleged event; and *United States v. Skolnik*, *supra*, at 706, excluding a record for lack of proof that it was prepared within a reasonable period.

Even if the lack of a foundation is overlooked, Exhibit A was still inadmissible hearsay. "The mere fact that the paper offered in evidence is taken from a business file and is otherwise proved in compliance with" section 1732 "does not establish its competency." *Schmeller v. United States*, *supra*, at 550. See also *Gordon v. Robinson*, 210 F. 2d 192, 196 (3d Cir. 1954). After the required foundation is laid, the offered writing must also satisfy a basic standard of trustworthiness which is implicit in the statute. *Medina v. Erickson*, 226 F. 2d 475, 482 (9th Cir. 1955), *cert. denied*, 351 U. S. 912 (1956); *Hartzog v. United States*, *supra*, at 710. The essence of this standard has been summarized in *Palmer v. Hoffman*, *supra*. The Business Records Act, the Supreme Court stated, relates to "entries made systematically or as a matter of routine to record events or occurrences, to reflect transactions with others, or to provide internal controls." The "basis of the rule" is "the trustworthiness of records because they were routine reflections of the day to day operations of the business." Admissibility hinges on "the character of the records and their earmarks of reliability" as "acquired from their source and origin and the nature of their compila-

¹¹ The records were also held inadmissible because of the nature of the entries which they contained. See further p. 51, *infra*.

tion." 318 U. S. at 113-114. As the Court of Appeals for the District of Columbia has expressed the same principle, the Act authorizes the admission of only those records "which are a product of routine procedure and whose accuracy is substantially guaranteed by the fact that the record is an automatic reflection of observations." *New York Life Insurance Co. v. Taylor*, 147 F. 2d 297, 303 (D.C. Cir. 1945). See also *Clainos v. United States*, *supra*, at 596; *Gordon v. Robinson*, *supra*, at 196.

The crux of trustworthiness, then, is that the records are "routine" or "automatic" reflections of business transactions. The records "are in practice accepted as accurate upon the faith of the routine itself, and of the self-consistency of their contents." *Massachusetts Bonding & Ins. Co. v. Norwich Pharmacal Co.*, 18 F. 2d 934, 937 (2d Cir. 1927). Hence the Court of Appeals for the District of Columbia pointedly holds that section 1732 is "limited to routine, clerical entries made contemporaneously with the event by a person charged with the duty of maintaining the records." *Schering Corp. v. Marzall*, *supra*, at 573-574. The statute is not an excuse for the free and easy introduction of hearsay reports of conversations in the course of business. To admit such reports "is to give any large organization the right to use self-serving statements without the important test of cross-examination. Cross-examination is unimportant in a case of systematic routine entries made by a large organization where skill of observation or judgment is not a factor." But the situation is quite different "where the accuracy of the entries depends on opinion, conjecture or judgment in selecting the particular entries from a larger mass of data which some other observer might consider equally relevant." And such entries are not within section 1732. *New York Life Ins. Co. v. Taylor*, *supra*, at 301, 304, 306.¹²

¹² See note 10, *supra*.

The contents of Exhibit A fall far short of the controlling principle of trustworthiness. To begin with, they are not the kind of "automatic" reflections which assure reliability. On the contrary, they are a highly condensed summary of conversations and discussions where the narrator has selected "the particular entries from a larger mass of data which some other observer might consider equally relevant." See p. 51, *supra*. Indeed, the Commissioner, no less than we, is completely in the dark concerning the preparation of this abbreviated version of what was supposedly said. The minutes themselves are undated. No evidence indicates when they were prepared. Cf. *Bruce v. McClure, supra*, at 334. As is often true of corporate minutes, they may well have been put together many days after the stated meeting amid fading recollections. Cf. *United States v. Indian Trailer Corp., supra*; *United States v. Skolnik, supra*. Nor is there any evidence which even shows who prepared the minutes and how he prepared them. While they are signed by Fitzgerald as Acting Secretary, it does not follow that he wrote them. Moreover, no evidence reveals whether the unidentified scrivener was personally present at the meeting, and, if he actually attended, whether the minutes came from scratch notes rapidly taken or mental notes precariously carried away. See *United States v. Bartholomew, supra*, at 708-709. And, of course, there is not the slightest evidence that Davidson ever saw the minutes or approved them.

All these missing links emphasize what seems clear—that Exhibit A does not have any of the required "earmarks of reliability." It is no more than an abstract prepared by someone who proceeded to pick and choose his recorded material from a much larger mass of oral discussion and comment. To make matters worse, inaccuracies and omissions were hardly unlikely, for the minutes purported to summarize discussions of four diverse financial matters, each with its own peculiar problems and ramifica-

tions. Here, then, the Tax Court did not admit a group of entries which derived from some routine clerical system allowing very little margin for error. It received, rather, a short extract of various conversations which was inherently loose and omissive. See p. 51, *supra*. In the very relevant words of the Court of Appeals for the District of Columbia, "The accuracy of such accounts is affected by bias, judgment, and memory; they are not the routine product of an efficient clerical system. There is here lacking any internal check on the reliability of the records in this respect, such as that provided for 'payrolls, accounts receivable, accounts payable, bills of lading and the like'." *New York Life Insurance Co. v. Taylor*, *supra*, at 300.

The minutes are inherently unreliable for still another reason. As we have noted, they purport to relate what Davidson said at a meeting of the executive committee of ABC-Delaware. His observations were designed to persuade the committee to advance \$350,000 to the subsidiary ABC-Portland. As a result, Davidson would be generously inclined to present the proposed loan of \$350,000 in the most favorable light for his purposes. He would naturally stress the reputation and prestige of E. Royce, who was a prominent businessman in Portland as well as a member of the purchasing group. Even if we assume that the minutes are accurate despite their obvious selectivity, at best they summarize the remarks of someone who would be prone to color and exaggerate. We do not intend to impugn the honesty or integrity of Davidson. We are only allowing for the customary patterns of human behaviour which are daily pursued in the utmost good faith. And so for this reason, too, the paper produced by the Commissioner failed to "bear the seal of trustworthiness." Cf. *Medina v. Erickson*, *supra*, at 482.

We have not yet exhausted the error of admitting Exhibit A. As the Third Circuit held in *Nicola v. United*

States, 72 F. 2d 780 (3d Cir. 1934), a writing does not qualify as competent evidence simply because it deals with matters of business. It is admissible only if it records a transaction which has already been consummated—not one which is still contemplated. The *Nicola* case aptly illustrates this principle. There the Government introduced a writing which instructed the bookkeeper to allocate profits to certain taxable entities. The Third Circuit held that the writing was erroneously admitted. “Books of account,” the Court stated, “consist of entries made in the regular course of business showing the transactions which have actually occurred in the business and not of orders, executory contracts, things to be done subsequent to the entries, or of methods and principles according to which the business must be conducted and entries made.” Book entries relating to sales are not competent evidence, the Court continued, “if the goods are charged before the contracts of sale are complete.” In order to be admissible an entry “must be the registry of a sale and delivery or a transaction actually made of the things therein contained, at the time of their being so entered.” 72 F. 2d at 783. Cf. *Terminal Railroad Association*, 17 B.T.A. 1135, 1165 (1929).

The *Nicola* opinion equally applies here. The question to be resolved is whether ABC-Portland loaned \$350,000 to Bentson, as five witnesses testified, or whether it loaned \$350,000 to any of the other five stockholders, as the Commissioner contends. On this question Exhibit A has nothing to say. For the minutes in the exhibit do not purport to record any loan which “actually occurred in the business” of ABC-Portland or was “actually made” by that corporation. At most they supposedly summarize, in very brief fashion, a discussion of “things” which may “be done” by ABC-Portland “subsequent to the entries.” We may state the same conclusion somewhat differently. In the language of section 1732, the “act, transaction, occurrence, or event” involved here is the precise loan made by ABC-Portland. But the only “act, transaction, occurrence, or

event," if any, recorded in the minutes is the contingent approval of an advance to be made by ABC-Delaware to ABC-Portland for a stated purpose, as distinguished from any loan actually made by ABC-Portland in the course of its business. To the extent that the minutes go further, they are only a hearsay report of conversations kept by a stranger to the loan made by ABC-Portland. The question is not what Davidson may have said, but what ABC-Portland actually did. And Exhibit A does not record any transactions between ABC-Portland and any of the petitioners. In contrast, the answer is plainly disclosed by the routine entries of ABC-Portland (Ex. D, E, G), as cogently supplemented by the uncontradicted testimony of E. Royce and the other petitioners. When all this oral and written evidence is put together, it was Bentson who owned the shares that were redeemed and it was Bentson who borrowed the money that was repaid.

The crux of the matter is that the Tax Court has rejected the sworn testimony of five witnesses in favor of one item of inadmissible hearsay. Income taxes, however, are real and onerous burdens. They are not to be complacently imposed on the basis of convenient conjecture and facile speculation, which are then feebly justified by rank hearsay. In the present context we cannot too strongly stress what the Supreme Court said many years ago. "The testimony of living witnesses personally cognizant of the facts of which they speak, given under the sanction of an oath in open court, where they may be subjected to cross-examination, affords the greatest security of truth." *Chaffee v. United States*, 18 Wall. 516, 541 (1873). And, as the Court has more recently warned, the Business Records Act does not contain any "major change which opens wide the door to avoidance of cross-examination." *Palmer v. Hoffman*, *supra*, at 114. These admonitions are peculiarly applicable here. The Government is taxing \$350,000 as income under cover of alleged evidence which is not only inadmissible, but wholly impervious to the

right of cross-examination—that right “which has always been regarded as the greatest safeguard of American trial procedure.” *New York Life Ins. Co. v. Taylor, supra*, at 305.

Here the Government’s resort to hearsay has been especially effective in “avoidance of cross-examination.” According to Exhibit A, at least seven persons attended the meeting of June 20th. These seven were Dick and Ebe, vice-presidents of ABC-Delaware; Burman, Cashmore and Kincaid, members of the executive committee; Davidson, vice-president of ABC-Portland; and Fitzgerald, acting secretary. Davidson died before the trial. (R. 212.) But so far as the record shows, the other six were fully available for testimony under oath. Yet the Government failed to call them. Nor can it be argued that they were too inadequately informed to testify. Exhibit A states that Ebe, together with Davidson, “submitted” the application considered; that the executives “reviewed in detail” the financial condition of Stages; that Dick’s “opinion was received;” and that the committee “approved” after “consideration and review.” Again, Exhibit A states that the executive committee’s action was “Subject to unanimous approval of full Portland Committee.” Nevertheless no member of the Portland Committee was placed on the stand. Once more the Government evinced little interest in oral testimony by those who were presumably informed. In short, no witness who had any direct knowledge relating to the loan was produced. Cf. *Lomax Transportation Co. v. United States*, 183 F. 2d 331, 334 (9th Cir. 1950); *Nettles v. Tillson, supra*, at 773. Instead, the Government was content to rest a very large deficiency on mere multiple hearsay.¹³ Wixson referred to what Fitzpatrick supposedly said ten years earlier. And Fitzpatrick allegedly said what Davidson allegedly said that E. Royce had allegedly

¹³ Schneider testified that Bentson conferred for several hours with the comptroller of Stages. See p. 34, *supra*. Yet the Government apparently made no effort to have the comptroller testify.

said. This kind of "evidence" is then dignified as competent and persuasive proof that E. Royce, rather than Bentson, acquired the 350 shares of Stages stock and borrowed the \$350,000 required to purchase those shares. Cf. *Parish's Estate v. Commissioner, supra*, at 395, which notes "the novel contention" that hearsay should be accepted as proof.

If ABC-Portland relied on this sort of hearsay in a suit to recover the \$350,000 from E. Royce, its cause of action would not get very far. The same evidence does not miraculously improve because the Government resorts to it as proof that E. Royce realized income of \$350,000 or some lesser sum.

The opinion of the Tax Court clearly reveals that its conclusion hinges on the so-called "reliable" evidence in Exhibit A. Since a judgment of deficiency based on inadmissible evidence cannot stand, the conclusion should be reversed. See *Baldwin v. Commissioner, supra*; *Parish's Estate v. Commissioner, supra*. Cf. *Hartzog v. United States, supra*; *Smallfield v. Home Ins. Co.*, 244 F. 2d 337 (9th Cir. 1957).

2. E. Royce Did Not Derive Any Income Even If the Stock and the Loan Are Attributed to Him

We have contended that E. Royce cannot be treated as the owner of the 350 shares held by Bentson or the borrower of the \$350,000 paid for the shares. However, even if the shares and the loan are nevertheless imputed to him, the \$350,000 cannot be taxed to him as a dividend within section 115(g).

A dividend, as commonly understood, is a corporate distribution of surplus which leaves the stockholder's equity and control substantially unimpaired. See *Hellmich v. Hellman*, 276 U. S. 233, 236-237 (1928); *Zenz v. Quinlivan, supra*, at 917; *Keefe v. Cote*, 213 F. 2d 651, 656 (1st Cir. 1954); *In re Lukens' Estate, supra*, at 405. Section 115(g) is narrowly concerned with redemptions which are "essen-

tially equivalent to the distribution of a taxable dividend." See p. 28, *supra*. Under the statute the significant question is "one of equivalence"—"whether the transaction has in substance the same characteristics, attributes, and effect as a dividend distribution." *Smith v. United States*, 130 F. Supp. 586, 590-591 (Ct. Cls. 1955). Therefore, when the Commissioner invokes section 115(g), "the effect of the distribution" is "compared with the declaration of a regular dividend." *Giles E. Bullock, supra*, at 292. "We must ask whether, viewing the transaction as a whole, different results were produced by what was in form a partial liquidation from the results that would have been produced, under the circumstances, by a dividend. If such a difference is found, Section 115 (g) is not applicable." *Northup v. United States*, 240 F. 2d 304, 306 (2d Cir. 1957). See further this Court's recent discussions in *Pacific Vegetable Oil Corp. v. Commissioner*, 57-2 U.S.T.C. ¶ 9823 (9th Cir. 1957); and *Phelps v. Commissioner*, 247 F. 2d 156 (9th Cir. 1957).

In view of this guiding principle a distribution in redemption which appreciably impairs a stockholders's proportionate interest is not taxable as dividend income. For the redemption then does not "accomplish the same result as the declaration of a dividend." *Earle v. Woodlaw*, 245 F. 2d 119, 129 (9th Cir. 1957), *cert. denied*, 354 U. S. 942 (1957). It is clearly a partial liquidation of his interest rather than a mere distribution of surplus. See *Commissioner v. Snite*, 177 F. 2d 819 (7th Cir. 1949); *Jones v. Griffin*, 216 F. 2d 885 (10th Cir. 1954); *Northup v. United States, supra*; *In re Lukens' Estate, supra*; *Rollin C. Reynolds*, 44 B.T.A. 342 (1941); *R. W. Creech*, 46 B.T.A. 93 (1942); *Marie W. F. Nugent-Head Trust*, 17 T.C. 817 (1951); *Giles E. Bullock, supra*; *Jackson Howell, supra*; *Estate of Henry V. Foster*, 3 T.C.M. 249 (1944); *Estate of Ira F. Searle, supra*; *Sam Rosania*, 15 T.C.M. 580 (1956); Rev. Rul. 56-183, 1956-1 Cum. Bull. 161; Rev. Rul. 56-540, 1956-2 Cum. Bull. 177.

The same result follows here if E. Royce is deemed to have owned the 350 shares. On that premise his total holdings were 495 shares before the redemption and 145 shares after the redemption. See p. 6, *supra*. The redemption, then, sharply reduced his percentage of ownership and control from 66 percent to 36 percent. As the cited cases indicate, this drastic impairment of equity is the very kind of redemption which is well beyond the reach of section 115(g). A "substantial change in the proportionate ownership and control of the corporation resulted from the distribution." And "the distribution was substantially different from what it would have been had the amount thereof been distributed as a dividend on the common stock." *Jones v. Griffin, supra*, at 887, 890. In the words of Judge Hastie, "through the redemption the taxpayer was doing no more than recouping his original capital investment, giving up in return the ownership rights represented by the redeemed stock. Certainly Section 115(g) was never intended to test the 16th Amendment conception of 'income' by placing such recoupment in the category of taxable income." *In re Lukens' Estate, supra*, at 407.

Section 115(g) still fails to apply, though the 350 shares and the distribution in redemption are attributed to E. Royce.

C. The Tax Court Erroneously Treated the Commissioner's Determination as Evidence

We have argued that the Tax Court's conclusion is irreconcilable with the evidence. We have also argued that its conclusion is largely rooted in one item of inadmissible hearsay. The Tax Court, however, committed still another error. It wrongfully regarded the Commissioner's determination as evidence to be balanced against the petitioners' proof.

At the end of its findings of fact the Tax Court states, "The record fails to overcome the determination of re-

tially equivalent to the distribution of a taxable dividend.” See p. 28, *supra*. Under the statute the significant question is “one of equivalence”—“whether the transaction has in substance the same characteristics, attributes, and effect as a dividend distribution.” *Smith v. United States*, 130 F. Supp. 586, 590-591 (Ct. Cls. 1955). Therefore, when the Commissioner invokes section 115(g), “the effect of the distribution” is “compared with the declaration of a regular dividend.” *Giles E. Bullock, supra*, at 292. “We must ask whether, viewing the transaction as a whole, different results were produced by what was in form a partial liquidation from the results that would have been produced, under the circumstances, by a dividend. If such a difference is found, Section 115 (g) is not applicable.” *Northup v. United States*, 240 F. 2d 304, 306 (2d Cir. 1957). See further this Court’s recent discussions in *Pacific Vegetable Oil Corp. v. Commissioner*, 57-2 U.S.T.C. ¶ 9823 (9th Cir. 1957); and *Phelps v. Commissioner*, 247 F. 2d 156 (9th Cir. 1957).

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At the end of its findings of fact the Tax Court states, "The record fails to overcome the determination of re-

spondent that Bentson was not a bona fide participant in the transactions leading up to the acquisition of Stages stock and was not a bona fide stockholder in Stages at all times material." "The respondent's determination that the corporate distributions by Stages, in retirement of the 350 shares of its stock issued in the name of Bentson and in payment of certain incidental expenses, were made at a time or under such circumstances as to be essentially equivalent to dividends taxable to petitioners, is not overcome by the evidence of record." (R. 236.) Then, toward the end of its opinion, the Tax Court restates the same conclusion. "On this issue," it says, "respondent is sustained for lack of proof of error." (R. 244.)

These quotations reflect a serious misunderstanding concerning the effect of the Commissioner's determination in the light of the taxpayers' evidence.

The Commissioner's determination of a deficiency is initially presumed to be correct. *Old Mission Co. v. Helvering*, 293 U. S. 289, 294 (1934). But this presumption of correctness does not have any weight as evidence. It merely calls upon the taxpayer to produce contrary proof. And when he produces such proof, the presumption promptly disappears. *J. M. Perry & Co. v. Commissioner*, 120 F. 2d 123 (9th Cir. 1941); *San Joaquin Brick Co. v. Commissioner*, 130 F. 2d 220 (9th Cir. 1942); *Hemphill School v. Commissioner*, 137 F. 2d 961 (9th Cir. 1943). Once the taxpayer has introduced competent and relevant evidence, "the issue depends wholly upon the evidence so adduced and the evidence to be adduced by the Commissioner. The Commissioner cannot rely upon his determination as evidence of its correctness either directly or as affecting the burden of proof." *J. M. Perry & Co. v. Commissioner*, *supra*, at 124.¹⁴ As a scholarly analysis states, "The pre-

¹⁴ For other decisions to the same effect, see *Wiget v. Becker*, 84 F. 2d 706 (8th Cir. 1936); *E. Albrecht & Son v. Landy*, 114 F. 2d 202 (8th Cir. 1940); *Helvering v. Talbott's Estate*, 116 F. 2d 160 (4th Cir. 1940); *Crude Oil Corp. v. Commissioner*, 161 F. 2d 809 (10th Cir. 1947); *Belyea's Estate*

sumption of correctness may not be weighed against the taxpayer's evidence." Ness, *The Role of Statutory Presumptions in Determining Federal Tax Liability*, 12 Tax L. Rev. 393, 408 (1957).

Here, however, the Tax Court has done precisely what it should not do. Though the petitioners produced ample evidence in denial of the determination, the Tax Court nevertheless treated the determination as evidence to be weighed in the balance. To use the Tax Court's own words, it twice found that "the evidence of record" failed to "overcome" the "determination." See pp. 59-60, *supra*. But, clearly, there was no "determination" to be "overcome" after the petitioners had produced contrary evidence. "Once such evidence is presented, the presumption becomes inoperative and the issue is to be determined as if there had never been a presumption." Cf. *Webre Steib Co. v. Commissioner*, 324 U.S. 164, 171 (1945). The appropriate question is how the petitioners' evidence compared with the Commissioner's evidence, not whether the petitioners' evidence was more persuasive than the Commissioner's prior determination. Since the Tax Court was concerned with the wrong question, it was able to find that there was "lack of proof of error." At the very least, the petitioners had produced "proof of error," and that proof controlled unless it was impaired by proof from the Commissioner.

The Tax Court's undue regard for the Commissioner's determination is the very kind of error which prompted reversals in *Wiget v. Becker*, 84 F. 2d 706 (8th Cir. 1936), and *Hemphill School v. Commissioner*, *supra*.

v. Commissioner, 206 F. 2d 262 (3d Cir. 1953); *Kentucky Trust Co. v. Glenn*, 217 F. 2d 462 (6th Cir. 1954); and cf. *Del Vecchio v. Bowers*, 296 U. S. 280, 285-286 (1935); *N. Y. Life Insurance Co. v. Gamer*, 303 U. S. 161, 171 (1938); *Webre Steib Co. v. Commissioner*, 324 U.S. 164, 170-171 (1945); *United Business Corp. v. Commissioner*, 62 F. 2d 754, 755 (2d Cir. 1933), *cert. denied*, 290 U. S. 635 (1933); *First Trust & Deposit Co. v. Shaughnessy*, 134 F. 2d 940, 941 (2d Cir. 1943), *cert. denied*, 320 U. S. 744 (1943).

In the *Wiget* case the taxpayer's liability turned on the value of stock as of certain dates. The value fixed by the Commissioner was less than the value set by the taxpayer. The trial court sustained the Commissioner. It ruled, *inter alia*, that "no substantial evidence" had "been introduced" supporting a judgment for the taxpayer; that she had "failed to sustain the burden of proof resting upon her to establish the illegality" of the alleged overassessment; that she had "failed to overcome the prima facie case as established by the assessment;" and that under "the uncontradicted evidence" she was not entitled to any recovery. 84 F. 2d at 707. The Eighth Circuit quickly disposed of this reasoning. "It is apparent from the conclusions of law," Judge Gardner wrote, that "great stress was placed upon the presumption of correctness of the determination" made by the Commissioner. While the determination was presumably correct, the presumption was merely rebuttable. It could "only support a finding in the absence of any substantial evidence to the contrary." The conclusions of law, Judge Gardner continued, indicated that the lower court erroneously treated the presumption as "evidence in the claimant's favor." Both parties had "submitted substantial evidence on the issue before the court, and in that state of the record the presumption passed out of the case." *Id.* at 707-708.

The story was the same in the *Hemphill* case. There the question was whether the corporate taxpayer had accumulated its profits "for the purpose of preventing the imposition of the surtax upon its shareholders." Under the relevant statute the accumulation of profits "beyond the reasonable needs of the business" was "prima facie evidence of a purpose to avoid surtax." Revenue Act of 1934, § 102(a), (b). Both sides introduced evidence, and the Tax Court sustained the Commissioner. It held that the Commissioner's determination was "presumed to be correct and must stand unless overcome by evidence;" that the "burden" was on the taxpayer "to establish that

undistributed accumulated profits were not beyond the reasonable needs of its business;" and that the evidence did "not overcome" the Commissioner's "determination" of surtax avoidance through an accumulation "beyond the reasonable needs of the business." 137 F. 2d at 963. This Court reversed even though the Commissioner had offered evidence in favor of his determination. If "no evidence had been produced," the Court reasoned, the Tax Court "would have had to accept the determination; for, until evidence was produced, the determination was presumed to be correct." But the taxpayer produced contrary evidence, and so "the presumption ceased, and thenceforth the issue depended 'wholly upon the evidence'." It was then "the duty" of the Tax Court "to find from the evidence, and from it alone," whether the accumulation exceeded "the reasonable needs" of the taxpayer's business. "No such finding was made." Instead the Tax Court "treated the presumption (which no longer existed) as if it were evidence, weighed it against petitioner's evidence and concluded that petitioner's evidence did not 'overcome' it." This Court remanded the case with explicit instructions to "find from the evidence, and from it alone," whether the taxpayer's accumulation was "beyond the reasonable needs of its business." *Id.* at 963-964.

In this case the Tax Court has done what this Court unmistakably proscribed in the *Hemphill* case. It has wrongly treated the presumption of correctness as having "the quality of affirmative evidence." Cf. *Del Vecchio v. Bowers*, *supra*, at 285. As in the *Hemphill* case, the Tax Court has regarded the presumption as the equivalent of proof which has to be "overcome." Indeed, the Tax Court's language here is just about the same as the language which caused the reversal in the *Hemphill* case. And as this Court held in the *Hemphill* case, it is immaterial that the Tax Court relied on some evidence produced by the Commissioner as well as his initial presumption of correctness. The vital consideration is that the Tax

Court's conclusion did not derive "from the evidence, and from it alone." See p. 63, *supra*.

Since the Tax Court paid excessive deference to the presumption of correctness, its decision was improperly reached—apart from the other mistakes which contributed to its conclusion. In fact, it is even doubtful whether the Commissioner ever started with any presumption of correctness in his favor. For, as we stated at the outset, the Commissioner made diverse determinations which are incompatible with each other. See pp. 31-32, *supra*. Cf. *Archer v. United States*, 77 F. Supp. 919, 921 (D. Mass. 1948), *rev'd on other grounds*, 174 F. 2d 353 (1st Cir. 1949); *Claire Giannini Hoffman*, 2 T.C. 1160, 1188 (1943); *Lawrence M. Hersig*, 4 T.C.M. 848, 850 (1945).

D. The Payment Is Not Taxable as Dividend Income Even If the Stock Was Acquired Pursuant to a Plan for Redemption

We shall now assume, as the Tax Court erroneously held, that Bentson was a mere straw for E. Royce and the other stockholders. See pp. 30-32, *supra*. Despite the evidence we shall further suppose, as the Commissioner successfully urged below, that they skillfully imported Bentson into the various transactions "pursuant to" a devious "plan" for a quick redemption of the 350 shares. See p. 31, *supra*. Even if these mistaken assumptions are accepted as correct, we submit that section 115(g) does not apply.

Tax statutes, like other statutes, "derive vitality from the obvious purposes at which they are aimed." *Griffiths v. Commissioner*, 308 U. S. 355, 358 (1939). See also *Haggar Co. v. Helvering*, 308 U. S. 389, 394 (1940). The animating purpose of section 115(g) is scarcely obscure. It is designed to reach redemptions of stock which serve as disguised dividends. See H. R. Rep. No. 1, 69th Cong., 1st Sess. 5 (1925); Sen. Rep. No. 52, 69th Cong., 1st Sess. 15 (1926); Conf. Rep. No. 350, 69th Cong., 1st Sess. 30 (1926); H. R. Rep. No. 2333, 77th Cong., 2d Sess. 49, 93

(1942); Sen. Rep. No. 1631, 77th Cong., 2d Sess. 116 (1942); H. R. Rep. No. 2319, 81st Cong., 2d Sess. 53 (1950); Sen. Rep. No. 2375, 81st Cong., 2d Sess. 42-48 (1950). See also pp. 57-58, *infra*. In response to its purpose section 115(g) is carefully confined to redemptions made "at such time and in such manner" as to be essentially equivalent to a dividend. Needless to say, a distribution in redemption of stock is not taxable as a dividend merely because it comes out of earnings or profits. Otherwise the special exception in section 115(g) would leave little of the general rule in section 115(c), which also contemplates the distribution of earnings. See *Commissioner v. Cordingley*, 78 F. 2d 118, 119 (1st Cir. 1935); *Commissioner v. Snite*, *supra*, at 821-823; *Zenz v. Quinlivan*, *supra*, at 917; *Clara Louise Flinn*, *supra*, at 1094; and pp. 28-29, *supra*. "Subdivision (g) makes an exception, but does not turn every partial liquidation into a dividend whenever there are undistributed earnings in the corporation. On the contrary, in such a case the partial liquidation is to be treated as the equivalent of a dividend only when made under certain specified circumstances. It is the time and manner of the liquidation, not the existence of undistributed earnings, which make the distribution essentially equivalent to a taxable dividend." *Commissioner v. Brown*, 69 F. 2d 602, 603 (7th Cir. 1934), *cert. denied*, 293 U. S. 570 (1934). See also *Hyman v. Helvering*, 71 F. 2d 342, 344 (D.C. Cir. 1934), *cert. denied*, 293 U. S. 570 (1934). "There is no inference or presumption which arises solely from a redemption of stock that such redemption is a dividend." *Parker v. United States*, 88 F. 2d 907, 909 (7th Cir. 1937).

The crux of the matter, then, is "the time and manner" of the redemption. And this controlling limitation is quite cogent in the present context where—if the Commissioner's view is right—the redemption was merely a planned step in the acquisition of a close corporate enterprise. According to the Commissioner and the Tax Court, the five petitioners desired to buy only the corporate equity

attributable to 400 shares. The Commissioner expressly determined that they purchased 400 shares in all. The other 350 shares, he concluded, were but temporarily held and expeditiously redeemed as a means of eliminating the balance of the equity which they did not intend to acquire. (R. 25, 88, 128, 188, 201.)

Very often when a close corporation is sold, the buyer does not have enough cash to purchase the entire equity represented by the stock. In these circumstances corporate funds are commonly used in order to consummate the sale. This solution may in any event be appropriate if a substantial portion of the price is otherwise simply a transfer of cash by the buyer for cash in the corporation. In order to effect the sale one of two procedures is followed. The buyer may acquire a portion of the stock, while the seller has the balance redeemed by the corporation. See, e.g., *Zenz v. Quinlivan*, *supra*; *Ray Edenfield*, *supra*. Cf. Rev. Rul. 56-556, 1956-2 Cum. Bull. 177. Or the buyer may arrange a temporary loan, acquire all the stock, and have a portion promptly redeemed in order to repay the loan. The purpose and result are the same, no matter which route is taken. In each case the buyer does not intend to obtain the equity consisting of the cash distributed on the redemption; in each case the redemption is solely designed to enable the buyer to make the purchase; and in each case the buyer invests only in the equity as reduced by the cash distributed on the redemption.

If the first course is followed, the distribution in redemption is clearly not taxable as a dividend to the buyer. *Ray Edenfield*, *supra*. Cf. *Schmitt v. Commissioner*, 208 F. 2d 819 (3d Cir. 1954); *S. K. Ames, Inc.*, 46 B.T.A. 1020 (1942); *Lloyd H. Diehl*, 1 T.C. 139 (1942), *aff'd*, 142 F. 2d 449 (6th Cir. 1944). We respectfully submit that if the second course is followed, the tax consequences to the buyer are no different. Our view is firmly fortified by *Fox v. Harrison*, 145 F. 2d 521 (7th Cir. 1944).

In the *Fox* case the taxpayer and another individual named Cross owned all the stock of a corporation. Cross insisted on a redemption of his shares, but the corporation was not financially able to comply. Therefore, the taxpayer personally borrowed the necessary funds and acquired Cross' shares. In the following year the taxpayer turned in a portion of the shares to the corporation for a sum equal to the price which he had paid for them. He then applied the same amount against his bank loan. The Government argued that the sum received from the corporation was taxable to him as a dividend under section 115(g). The Seventh Circuit was not persuaded.

The Government's theory, the Court declared, was "apparently predicated upon the mere form of the transaction, without giving consideration to the substance. In reality, the involved stock was purchased by the corporation from Cross. That the purchase was not made directly from him was due to the inability of the corporation readily to finance such purchase." The taxpayer "merely supplied the security by which the finances were obtained. The very checks which he received for the stock when it was turned over to the corporation were used in payment of the loan which he had obtained from the bank. He realized no gain or profit on the transaction." The taxpayer acquired the stock "as a temporary expedient" until the corporation would have sufficient funds to take it off his hands. "He had no desire or purpose to make a permanent or personal investment in the Cross stock." The Court concluded, "When we look at the undisputed purpose back of this transaction, together with the 'time' and 'manner' of the distribution by the corporation" to the taxpayer, "we are of the view that it was not 'essentially equivalent to the distribution of a taxable dividend.' " 145 F. 2d at 522-523.

The *Fox* opinion dealt with the acquisition of corporate ownership by an existing stockholder, while the present case involves the acquisition of corporate ownership by

a new group of stockholders. But the *Fox* opinion applies just as aptly here if the Commissioner's understanding of the facts is correct.

As the Commissioner sees the facts, Niederkrome, E. Royce, B. Royce, Jacob and Schneider wished to acquire only 400 of the 750 shares. An agreement was drafted which would have enabled the corporation to redeem the other 350 shares from the sellers.¹⁵ If the transaction had proceeded along those lines, the distribution would not have been a dividend to the buyers. See p. 66, *supra*. That agreement, however, was not executed. Instead, the Commissioner says, the buyers used Bentson as a straw for the 350 shares; and he was used as a straw because they contemplated a prompt redemption of those shares in order to pay off the loan of \$350,000. If this view of the transaction is correct, then, in the fitting words of the *Fox* opinion, the purchasers "had no desire or purpose to make a permanent or personal investment" in the 350 shares. The shares were received "as a temporary expedient" pending their early acquisition by the corporation. The "very" check "received for the stock when it was turned over to the corporation" was "used in payment of the loan" obtained for the acquisition of the stock. And so here, as in the *Fox* case, when we look at "the substance" rather than "the mere form of the transaction"—"the undisputed purpose back of this transaction, together with the 'time' and 'manner' of the distribution"—the redemption is not "essentially equivalent" to a dividend. "In reality" the shares "were purchased by the corporation" from the old stockholders, with the new stockholders merely serving as a conduit. The new stockholders "realized no gain or profit on the transaction."

Our position makes good sense as well as good law. Where the buyer intends to invest in only the corporate equity represented by a portion of the stock, the economic

¹⁵ See p. 4, *supra*.

substance is precisely the same whether the corporation redeems the balance of the stock from the seller or from the buyer. Usually the buyer will prefer to have the seller effect the redemption; and then, of course, the redemption is not taxable as a dividend. But if the seller refuses to turn in a portion of his stock, the buyer has no choice but to acquire the unwanted balance as a mere step in the contemplated redemption.¹⁶ Surely the tax consequences do not critically vary, depending on whether the seller is willing to redeem the undesired shares. Otherwise essentially the same transactions will be diversely taxed for irrelevant reasons. And the buyer will be severely penalized because the seller is stubborn and unyielding. Such "unwitty diversities" should not be gratuitously attributed to Congress—especially where the statute invoked is sensitively concerned with the economic substance of transactions. Cf. *Helvering v. Hallock*, 309 U. S. 106, 118 (1940).

"Taxation, as it has many times been said, is eminently practical" (*Tyler v. United States*, 281 U. S. 497, 503 (1930)), and hence it is responsive to practical considerations. We are only saying what the Commissioner himself usually says and the courts repeatedly approve. "A given result at the end of a straight path is not made a different result because reached by following a devious path." *Minnesota Tea Co. v. Helvering*, 302 U. S. 609, 613 (1938); *Griffiths v. Commissioner*, *supra*, at 358. As the Commissioner recently declared, "In determining the substance of a transaction, the situation as it existed in the beginning and at the end of a series of steps and the object sought to be accomplished should be considered." Rev. Rul. 57-469, I.R.B. 1957-42, pp. 60, 61. This principle seems even more appropriate where the deviation from the straight path was compelled by others. If the buyers here

¹⁶ We are not in any way agreeing that the five stockholders, other than Benton, actually acquired the 350 shares in his name under a plan to redeem them. We are merely pursuing the legal effect of the Commissioner's insistence that there was such a plan.

a new group of stockholders. But the *Fox* opinion applies just as aptly here if the Commissioner's understanding of the facts is correct.

As the Commissioner sees the facts, Niederkrome, E. Royce, B. Royce, Jacob and Schneider wished to acquire only 400 of the 750 shares. An agreement was drafted which would have enabled the corporation to redeem the other 350 shares from the sellers.¹⁵ If the transaction had proceeded along those lines, the distribution would not have been a dividend to the buyers. See p. 66, *supra*. That agreement, however, was not executed. Instead, the Commissioner says, the buyers used Bentson as a straw for the 350 shares; and he was used as a straw because they contemplated a prompt redemption of those shares in order to pay off the loan of \$350,000. If this view of the transaction is correct, then, in the fitting words of the *Fox* opinion, the purchasers "had no desire or purpose to make a permanent or personal investment" in the 350 shares. The shares were received "as a temporary expedient" pending their early acquisition by the corporation. The "very" check "received for the stock when it was turned over to the corporation" was "used in payment of the loan" obtained for the acquisition of the stock. And so here, as in the *Fox* case, when we look at "the substance" rather than "the mere form of the transaction"—"the undisputed purpose back of this transaction, together with the 'time' and 'manner' of the distribution"—the redemption is not "essentially equivalent" to a dividend. "In reality" the shares "were purchased by the corporation" from the old stockholders, with the new stockholders merely serving as a conduit. The new stockholders "realized no gain or profit on the transaction."

Our position makes good sense as well as good law. Where the buyer intends to invest in only the corporate equity represented by a portion of the stock, the economic

¹⁵ See p. 4, *supra*.

substance is precisely the same whether the corporation redeems the balance of the stock from the seller or from the buyer. Usually the buyer will prefer to have the seller effect the redemption; and then, of course, the redemption is not taxable as a dividend. But if the seller refuses to turn in a portion of his stock, the buyer has no choice but to acquire the unwanted balance as a mere step in the contemplated redemption.¹⁶ Surely the tax consequences do not critically vary, depending on whether the seller is willing to redeem the undesired shares. Otherwise essentially the same transactions will be diversely taxed for irrelevant reasons. And the buyer will be severely penalized because the seller is stubborn and unyielding. Such "unwitty diversities" should not be gratuitously attributed to Congress—especially where the statute invoked is sensitively concerned with the economic substance of transactions. Cf. *Helvering v. Hallock*, 309 U. S. 106, 118 (1940).

"Taxation, as it has many times been said, is eminently practical" (*Tyler v. United States*, 281 U. S. 497, 503 (1930)), and hence it is responsive to practical considerations. We are only saying what the Commissioner himself usually says and the courts repeatedly approve. "A given result at the end of a straight path is not made a different result because reached by following a devious path." *Minnesota Tea Co. v. Helvering*, 302 U. S. 609, 613 (1938); *Griffiths v. Commissioner*, *supra*, at 358. As the Commissioner recently declared, "In determining the substance of a transaction, the situation as it existed in the beginning and at the end of a series of steps and the object sought to be accomplished should be considered." Rev. Rul. 57-469, I.R.B. 1957-42, pp. 60, 61. This principle seems even more appropriate where the deviation from the straight path was compelled by others. If the buyers here

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had been free to take a direct route, they would have bought 400 shares and the corporation would then have redeemed the other 350 shares. According to the Commissioner, however, the buyers had to take a circuitous route; and so they temporarily acquired the 350 shares before those shares were redeemed.¹⁷ The acquisition was one of those "transitory arrangements" and "procedural devices" which are commonly disregarded for tax purposes because "they add nothing of substance to the completed affair." See *Helvering v. Bashford*, 302 U. S. 454, 458 (1938); *Helvering v. Limestone Co.*, 315 U. S. 179, 184 (1942). For the contemplated end result was an investment limited to the equity inhering in 400 shares.

"Substance and not form controls in applying a tax statute." *Halliburton v. Commissioner*, 78 F. 2d 265, 267 (9th Cir. 1935). We need hardly add that this canon is not a one-way street for the exclusive use of the Commissioner. If a taxpayer sought to avoid a tax "by asking the Commissioner to ignore the actualities, he would shortly and properly be reminded that taxation is an intensely practical matter and that the substance of the thing done, and not the form it took, must govern." The Commissioner is equally restrained from imposing a tax by ignoring the actualities—especially if the actualities reflect his own view of the transaction. Hence he cannot "treat two steps in a single transaction as two separate transactions." See *Prairie Oil & Gas Co. v. Motter*, 66 F. 2d 309, 311 (10th Cir. 1933); *First Seattle D. H. Nat. Bank v. Commissioner*, 77 F. 2d 45, 49 (9th Cir. 1935). That is exactly what the Tax Court has permitted him to do here if the Commissioner's version of what happened is correct.

In support of its position the Tax Court cited *Wall v. United States*, 164 F. 2d 462 (4th Cir. 1947); *Holloway v. Commissioner*, 203 F. 2d 566 (6th Cir. 1953), *aff'g* 10 T.C.M. 1257 (1951); and *Woodworth v. Commissioner*,

¹⁷ See note 16, *supra*.

218 F. 2d 719 (6th Cir. 1955). These three decisions, however, are readily distinguished from the present case.

In the *Wall* case the taxpayer and another individual each owned 50 percent of the stock of a corporation. The two failed to get along, and in 1937 the taxpayer bought the other's stock for \$57,000. The purchase price was payable over ten years, and the deferred payments were represented by notes secured by the acquired shares. In 1939 the taxpayer transferred the shares to the corporation, which, in turn, agreed to pay the remaining notes. The corporation made a payment in the same year, which the Government then treated as a dividend to the taxpayer under section 115(g). The Fourth Circuit sustained the Government on the ground that the corporation's discharge of his indebtedness was in effect a dividend to him. 164 F. 2d at 464. The Court carefully distinguished *Fox v. Harrison, supra*, as involving a temporary acquisition without any true intention of holding the stock as owner. On the other hand, in the *Wall* case the purchase from the other stockholder in 1937 and the sale to the corporation in 1939 were "two distinct transactions." The taxpayer first acquired the stock as an investment and later decided to turn it in. *Id.* at 465-466.

The situation was essentially the same in the *Holloway* case.¹⁸ The taxpayer and another group of stockholders were engaged in litigation. In settlement of the suits the taxpayer bought the stock of his adversaries for \$37,500. He paid this sum out of corporate funds. Later he had the corporation redeem and cancel the acquired shares. The Tax Court concluded that the taxpayer had bought the stock for himself, and that the corporation's concurrent discharge of his obligation to the seller was a dividend. It held that the purchase of the stock and the later redemption of the stock were "two separate and dis-

¹⁸ Our summary of the facts is taken from the Tax Court's opinion in 10 T.C.M. 1257 (1951).

tinnet transactions.” 10 T.C.M. at 1261. The Sixth Circuit affirmed the Tax Court’s decision on the basis of its findings.

In the *Woodworth* case the taxpayers were members of a syndicate which in 1943 bought all the stock of a corporation. The purchasers paid for the stock by borrowing the necessary funds from the corporation. In return they gave the corporation promissory notes secured by their stock. At various times between 1943 and 1945 they made payments on the notes. In 1945 the corporation was advised that the issuance of stock for notes was illegal under state law. Therefore, at the end of that year the stockholders surrendered 75 percent of their shares in cancellation of their remaining notes of \$255,000. The Sixth Circuit held that the later cancellation of indebtedness on the redemption of the stock was taxable as a dividend.

The three decisions just summarized are variations of the same theme. In all three the taxpayers purchased the stock involved as an investment for themselves, and later they had the corporation discharge their indebtedness attributable to the prior purchase. Here, however, the situation is quite different if the Commissioner’s understanding of the facts is correct. In his view, which the Tax Court affirmed, the five taxpayers did not intend to purchase the 350 shares as an investment. From start to finish they intended the corporation to acquire those shares pursuant to a previously devised plan. Their acquisition of the shares was a mere transitory arrangement which was to be rapidly undone. As in *Fox v. Harrison*, *supra*, the purchasers simply served as a conduit for the corporation.

We have argued that under the Commissioner’s own theory of a plan of redemption, the payment of the \$350,000 is not taxable as dividend income. We now submit that even apart from the plan alleged by the Commissioner, the result is the same. Again it is assumed *arguendo* that the

350 shares were held by Bentson for the other five stockholders.

A dividend, as generally understood, is a return on an investment in stock. See *Hellmich v. Hellman*, *supra*, at 236-237. Section 115(g) is directed against those stockholders who seek to disguise their return as a redemption of stock. See p. 64, *supra*. The scope and design of the statute have been delineated in reports of the House Ways and Means Committee and the Senate Finance Committee. "Assume," the reports state, "that two men hold practically all the stock in a corporation, for which each had paid \$50,000 in cash, and the corporation had accumulated a surplus of \$50,000 above its cash capital." If the corporation redeems, "for cash, one-half of the stock held by them," the redemption is, "in all essentials," the "equivalent of a distribution through cash dividends of earned surplus." H. R. Rep. No. 1, 69th Cong., 1st Sess. 5 (1925); Sen. Rep. No. 52, 69th Cong., 1st Sess. 15 (1926).

As these reports disclose, section 115(g) is not an indiscriminate provision which the Commissioner may loosely apply as he sees fit. At the very least the statute is confined to situations where the distribution consists of earnings over and above the investment of the stockholder. In the Committees' example the stockholders have paid in \$50,000 and the corporation has later earned \$50,000 more. By the same token, section 115(g) does not apply to a redemption of stock held by an intervening purchaser for value who merely receives the amount which he invested in the stock after the surplus was accumulated. The redemption, then, does not represent a distribution of earnings on an investment. It is only the return of the investment itself. *Parker v. United States*, *supra*. See *Commissioner v. Cordingley*, *supra*, at 120; *Commissioner v. Snite*, *supra*, at 823; *De Nobili Cigar Co.*, 1 T.C. 673, 681 (1943), *aff'd*, 143 F. 2d 436 (2d Cir. 1944). If a tax were imposed on the recoupment of the investment,

it would be a levy on capital, not on income. See *Parker v. United States*, *supra*, at 909; *Commissioner v. Cordingley*, *supra*, at 120; *In re Lukens' Estate*, *supra*, at 407. "Economic gain realized or realizable by the taxpayer is necessary to produce a taxable income under our statutory scheme." *Helvering v. Stuart*, 317 U. S. 154, 168 (1942).

The rule of the *Parker* case controls here if the 350 shares are attributed to the stockholders other than Bentson. The sum of \$350,000 was paid on the purchase of those shares, and the same sum was paid on their redemption.¹⁹ There is no dividend income to be taxed because only the capital outlay was returned. The situation of Niederkrome effectively demonstrates the point. On July 2, 1945, he bought 55 shares for \$55,000. On June 20, 1946, he had to sell the same 55 shares for \$55,000. (R. 225, 232.) Even if a portion of the 350 shares is imputed to Niederkrome, he still had no more at the end than he had at the beginning. To speak of a dividend here is to conjure a gain out of a return of capital. Yet the Tax Court has charged him with a dividend of \$48,125; and on the basis of this imaginary income he is subjected to a tax of \$32,348.48, a penalty of \$1,940.07, about 12 years' interest of \$23,000, or a total levy exceeding \$55,000—the amount of his investment. Recently the Third Circuit reminded the Tax Court that any attempt to tax a return of capital as a receipt of income needlessly provokes a serious constitutional question. Section 115(g) "was never intended" to place "such recoupment in the category of taxable income." See *In re Lukens' Estate*, *supra*, at 407. Evidently another reminder is not inappropriate.

In the light of our analysis we conclude that section 115(g) does not apply even if the Commissioner's appraisal of the facts is approved.

¹⁹ The small additional payment of \$3,739.73 is considered at pp. 75-76, *infra*.

E. The Incidental Disbursements Did Not Constitute Taxable Income

One small issue remains in regard to section 115(g). On July 19, 1945, Stages gave Davidson of ABC-Portland a check for \$4,315.07. He had billed Stages for this amount as a fee for financing the loan of \$350,000. The payment was charged to an expense account on the books of Stages. (R. 227.) On September 17, 1945, Stages issued a check for \$3,739.73 payable to ABC-Portland. This sum was equal to the interest then due on the loan of \$350,000 and was part of the price paid on the redemption of the 350 shares. The payment was charged to interest expense on the books of Stages. (R. 228, 231.) The Tax Court held that the disbursements for the "incidental expenses" of \$4,315.07 and \$3,739.73 were also taxable as dividends to the five stockholders other than Bentson. (R. 236.) The opinion of the Tax Court states, "As to the item of interest paid by the company in connection with the loan of \$350,000, there is in the record insufficient proof to enable us to hold that respondent erred in his treatment of such item." (R. 244.) The opinion says nothing in so far as the other item is concerned.

In view of our prior discussion little more need be said on the disbursements of \$4,315.07 and \$3,739.73. As Jacob testified, both items were erroneously charged as corporate expenses without his knowledge. Until the Government began its examination, he understood that the servicing fee of \$4,315.07 had been charged to Bentson as an account receivable. (R. 332-333, 342-343.) And the record further shows that the \$3,739.73 did not represent any interest owed by the corporation. See p. 7, *supra*. While book entries are of some evidential value, they do not determine tax liabilities. *Doyle v. Mitchell Brothers Co.*, 247 U. S. 179, 187 (1918). Besides, if the erroneous entries were deemed correct, they would only indicate that Stages was discharg-

ing its own obligations and not those of its stockholders.²⁰ In any event, regardless of how the two items were entered, neither is taxable as income to the stockholders other than Bentson. One item derived from Bentson's loan of \$350,000, and the other from the redemption of his 350 shares. Hence the two items are no more taxable to them than the \$350,000 which Bentson received on the redemption.

If the disbursements are regarded as pro rata dividend distributions to the other five stockholders, the net result is still the same. Under that view of the matter the disbursements are treated as income to them on the ground that they constructively paid their own personal obligations for the fee and the interest. But if this erroneous premise is pursued, the disbursements are also deductible by them. *George D. Mann*, 33 B.T.A. 281 (1935).²¹

II.

THE ADVANCE BY HIPPODROME TO E. ROYCE WAS NOT A DIVIDEND

In 1945 petitioner E. Royce was one of four shareholders in Hippodrome Amusement Company. He owned about 62 percent of its stock. On December 28th of the same year the corporation advanced \$20,000 to him. This sum was then continuously carried and recognized as a loan. See pp. 9-11, *supra*. Again, however, the Commissioner assiduously imagined some adroit venture in tax avoidance, and so he determined that the advance was a disguised dividend. Once more the Tax Court approved his position because it was inadequately attentive to the evidence. (R. 261-262.)

²⁰ Stages erroneously deducted the two disbursements. The Commissioner has disallowed the deductions, and Stages has concurred in the disallowance. (R. 332-333.)

²¹ A fee paid for a loan is deductible either as additional interest or as an amortizable cost over the life of the loan. *Wiggin Terminals, Inc.*, v. *United States*, 36 F. 2d 893 (1st Cir. 1929); *Julia Stow Lovejoy*, 18 B.T.A. 1179 (1930).

The governing principles are settled. When these principles are applied to the evidence, the advance was clearly what it purported to be—a loan and not a dividend.²²

“It is obvious,” as the Tax Court has held, “that a withdrawal by a stockholder of funds of a corporation does not necessarily constitute a distribution of profits, even if the corporation has an accumulation of profits in excess of the withdrawal; and such withdrawal may or may not, in the light of that fact alone, be said to be a dividend. A corporation may lend its funds, including earnings, with or without interest, upon open account or upon notes, secured or unsecured; and such privilege is not restricted to the lending of its funds to persons other than stockholders.” *Harry E. Wiese*, 35 B.T.A. 701, 704 (1937), *aff’d*, 93 F. 2d 921 (8th Cir. 1938), *cert. denied*, 304 U. S. 562 (1938). Therefore, a corporate advance does not become a dividend merely because the recipient is a shareholder and the corporation has an earned surplus. The important consideration is “whether he took it for permanent use in lieu of dividends or whether he was then only borrowing.” *Wiese v. Commissioner, supra*, at 923. “If the money advanced was in good faith loaned by the corporation” to the stockholder, “then it was not a dividend.” *Moses W. Faitoute*, 38 B.T.A. 32, 35 (1938). “It is the intent at the time the withdrawals were made which is determinative.” *Estate of Helene Simmons*, 26 T.C. 409, 423 (1956).²³

The evidence leaves no doubt that the \$20,000 was requested and received as a loan. From the very outset the

²² The opinion below refers to section 115(a) of the 1939 Code as the “appropriate statute.” This provision sheds no light here. It presupposes that a corporate disbursement is not a loan—which is the very question to be decided.

²³ In *Estate of Helene Simmons, supra*, at 423, the Tax Court adds: “If, at that time, the recipient intended the withdrawal to be a loan which he would repay but, in a later year, changed his mind, the withdrawal still qualifies as a loan in the year made and does not become income until such later year.” See further *Wiese v. Commissioner, supra*.

advance was consistently carried on Hippodrome's records as a receivable due from E. Royce.²⁴ As this Court has held in closely analogous circumstances, a book entry to this effect is "prima facie evidence of a debt," and "in the absence of countervailing evidence would be sufficient to establish the existence of the indebtedness." *Weaver v. Commissioner*, 58 F. 2d 755, 757 (9th Cir. 1932).²⁵ E. Royce should have prevailed on the basis of the entries alone, for the Commissioner failed to produce any "countervailing evidence."²⁶ On other occasions the Commissioner has been very happy to abide by book entries which recorded a loan from corporation to stockholders. See, e.g., *Wiese v. Commissioner*, *supra*; *Hudson v. Commissioner*, 99 F. 2d 630 (6th Cir. 1938), *cert. denied*, 306 U. S. 644 (1939); *Allen v. Commissioner*, 117 F. 2d 364 (1st Cir. 1941). However, the affirmative proof in behalf of E. Royce consisted of much more than corporate entries. Three witnesses, including E. Royce, persuasively confirmed the accuracy of the books. Their combined testimony plainly showed that the directors discussed the advance before it was made; that the advance was approved as a loan and has always been regarded as a loan; that repayment is to be made as soon as the corporation requires the money;

²⁴ The advance was initially carried as a receivable in an account entitled "Due from Stockholders." Later Niederkrome, without consulting anyone, transferred the advance to an account entitled "Notes Receivable—E. Royce." (R. 253-260, 420, 522-523.) When Niederkrome made this change, he was not aware that the Government was asserting a tax on the \$20,000 as dividend income. (R. 523.) E. Royce did not execute a note because he was unwilling to affect the status of the receivable while this litigation was pending. (R. 420, 426-427.)

²⁵ In the *Weaver* case the Commissioner sought to disregard a loan from stockholders to their corporation. The advance was made subject to a "verbal understanding that" it was to be repaid "at some future date." 58 F. 2d at 750. As in the present case, the Tax Court too easily agreed with the Commissioner. This Court reversed.

²⁶ The presumptive correctness of the Commissioner's determination is not "countervailing evidence." When the taxpayer's evidence appears, the presumption disappears. See pp. 59-64, *supra*.

that the corporation expects to be repaid and that E. Royce intends to repay it. (R. 412-413, 419-420, 423, 495-496, 501-502, 526, 566-567.) See further pp. 9-11, *supra*.

All the evidence, written and oral, is uncontradicted. It easily adds up to the one conclusion that the advance of \$20,000 was a loan. See *Wiese v. Commissioner, supra*; *Allen v. Commissioner, supra*; *Comey & Johnson Co., 8 B.T.A. 52 (1927)*; *Moses W. Faitoute, supra*; *Rollin C. Reynolds, supra*; *Irving T. Bush, 45 B.T.A. 609 (1941), remanded on other issues, 133 F. 2d 1005 (2d Cir. 1943)*; *Victor Shaken, 21 T.C. 785 (1954)*; *H. C. Thorman, 12 T.C.M. 963 (1953)*. Undoubtedly, if the corporation had become insolvent, the \$20,000 "would have been subject to recovery by the creditors of the company." *Commissioner v. Cohen, 121 F. 2d 348, 350 (5th Cir. 1941)*. See also *Harry E. Wiese, supra, at 704*; *Moses W. Faitoute, supra, at 35*. Or, "if by reason of a new venture or an expansion of business, the corporation needed additional funds, which were furnished by petitioner and credited on his account, it would not have constituted a contribution of capital but a payment of his indebtedness to the corporation." *Harry E. Wiese, supra, at 705*.

While the Tax Court observed that its decision should derive "from all the facts and inferences found on the record," it nevertheless held that the advance was "intended to be and was in fact a distribution of profits and not a loan to Royce." (R. 262.) The court made no illuminating appraisal of the evidence.²⁷ It simply mustered two arguments for what it described as its "well buttressed" conclusion. First, it had "searched the record in vain for a valid or persuasive reason" for a loan of \$20,000 to a stockholder whose net worth exceeded \$1,000,000. Second, it was equally unable to "find a valid

²⁷ The Tax Court's opinion, after stating the question and the applicable principles, consists of eight sentences. (R. 262.) Of these eight sentences, six merely reiterate in varying ways that the Government is right and the taxpayer is wrong.

or persuasive reason'' why the advance was not repaid if it was a loan. (R. 262.) Apart from these observations, no attempt was made to sustain the result reached.

Here again the Tax Court is grasping at straws. A stockholder's purpose in seeking a corporate advance is irrelevant in determining whether the advance is a loan or a dividend. In either case the stockholder acquires dominion over funds for his own personal use. The relevant question is whether the amount received is to be repaid. See p. 77, *supra*. Advances have been regularly considered loans regardless of the particular purpose which prompted the stockholders to obtain them. See, *e.g.*, *Wiese v. Commissioner*, *supra*; *Comey & Johnson Co.*, *supra*; *Moses W. Faitoute*, *supra*; *Victor Shaken*, *supra*; *Walter Freeman*, 16 T.C.M. 71 (1957). Nor is the Tax Court's conclusion bolstered by comparing the advance of \$20,000 to E. Royce's larger net worth. In fact, at this point its reasoning is exceedingly strange. The Tax Court has repeatedly indicated exactly the opposite—that an ample ability to repay an advance is corroborative proof that the advance was a loan and not a dividend. See *Comey & Johnson Co.*, *supra*, at 54; *Herman M. Rhodes*, 34 B.T.A. 212, 216 (1936), *rev'd on other issues*, 100 F. 2d 966 (6th Cir. 1939); *Rollin C. Reynolds*, *supra*, at 351; *William C. Baird*, 25 T.C. 387, 395-396 (1955); *Estate of Helene Simmons*, *supra*, at 424. If the alleged borrower has "substantial assets" for repayment, his testimony that a loan was intended "cannot be passed over lightly." *Estate of Isadore Benjamin*, 28 T.C. 101, 111 (1957).

We need not spend much time on the Tax Court's second ground—that the evidence does not adequately indicate why the loan was not yet repaid. The matter was fully explained in the oral testimony²⁸ and then completely ignored in the Tax Court's findings. This kind of fact finding

²⁸ See pp. 9-11, *supra*.

is a sufficient commentary on the court's assertion that the "greater probative weight of the evidence" is "in opposition to petitioner's contention." (R. 262.) We may add that "evidence" can hardly have "greater probative weight" if it is non-existent.

The Tax Court also commends its conclusion for the "greater logic" which it reflects. (R. 262.) The "greater logic" is nowhere explained. At any rate, in the quest for logic some important details were too easily overlooked. One ignored item was the past financial nexus between E. Royce and the corporation. As the Tax Court found, in the early years E. Royce had helped to carry the corporation through a decade of losses. (R. 260.) At no time, Niederkrome explained, were any "formal notes signed by the Hippodrome to him." (R. 495.) Since E. Royce had "come to the rescue of the corporation" in the "lean" years, it was reasonable to accommodate him "when the situation was reversed," as long as the corporation did not need the funds. (R. 495, 521-522.) In other words, we have here the common situation where stockholder and corporation have "alternately enjoyed the use of the other's money for different periods." *H. C. Thorman, supra*, at 966.²⁹

The Tax Court also neglected another very informative detail. Apart from E. Royce, there were three shareholders who owned almost 40 percent of the stock. Yet none of them received a comparable payment. "It would not seem reasonable" that stockholders, "owning a substantial amount of stock, would permit another stockholder to withdraw money from the corporation in excess of his pro rata share of dividends and his salary unless there

²⁹ Cf. *Moses W. Faitoute, supra*, at 35: "He could have borrowed the money from a bank, since his credit was good, but the corporation had funds in the bank which were drawing little or no interest, and instead of going to a bank for a loan he went to the corporation."

was to be an accounting to the corporation for such amounts.” *Comey & Johnson Co., supra*, at 54. See also *Rollin C. Reynolds, supra*, at 351. We fully concur in what the Government successfully urged in *Commissioner v. Cohen, supra*. A loan is persuasively shown if only one stockholder has made a withdrawal “and no other stockholder either received or had an enforceable right to demand any dividends.” 121 F. 2d at 350.

When the advance of \$20,000 was made, Hippodrome’s earned surplus was about the same amount. We can think of no reason why three shareholders, owning approximately 40 percent of the stock, would permit a fourth stockholder to appropriate the entire surplus as a dividend. The Tax Court has been similarly unequal to the task of providing a rational explanation.

We submit that the conclusion below has no basis whatever in the record. The Tax Court’s authority to weigh evidence is not an authority to ignore it. Cf. *Weaver v. Commissioner, supra*.

III.

DORA F. ROYCE IS A MEMBER OF THE PORTLAND PARTNERSHIP AND HER DISTRIBUTIVE SHARE OF THE INCOME IS NOT TAXABLE TO E. ROYCE

In August, 1942, Dora F. Royce acquired a capital interest of 23.06 percent in Yellow Cab Company, a partnership doing business in Portland, Oregon. She obtained her interest as a gift from her husband E. Royce. She executed the articles of partnership and the Assumed Business Name Certificate; she regularly performed important services in the business and participated in the management; she had her own capital and drawing accounts on the books of the partnership; and she received her share of the profits along with the other partners. See pp. 11-14, *supra*. The Tax Court has held that Dora “was not a bona fide partner,” and that her share of the profits for the

years 1944-1947 is therefore taxable to E. Royce. (R. 275-278.) In our view the Tax Court has clearly erred.

The applicable statutes are sections 181 and 182 of the 1939 Code. Section 181 states, "Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity." Section 182 provides that each partner shall report his distributive share of the income or losses of the partnership. For present purposes these statutes have been authoritatively construed in *Commissioner v. Culbertson*, 337 U. S. 733 (1949), to which we now turn. The decision below is still another example of the Tax Court's recurring failure to apply the lessons of the *Culbertson* case.

The *Culbertson* case articulates four basic rules. First, the concept of partnership in the income tax law is the same as the concept of partnership in commercial law. "A partnership is, in other words, an organization for the production of income to which each partner contributes one or both of the ingredients of income—capital or services." 337 U. S. at 740. The question is "one concerning the bona fide intent of the parties to join together as partners;" and a party displays the requisite intent by contributing either services or capital. *Id.* at 743, 747. Or, as Mr. Justice Frankfurter stated in his concurring opinion, family partnerships are not to be disregarded "as partnerships for income-tax purposes even though they be genuine commercial partnerships." The term "partnership" in sections 181 and 182 does not have "a content peculiar to the Internal Revenue Code." The customary criteria which determine the existence of a partnership also "apply in tax cases when the Government challenges the existence of a partnership for tax purposes." "In plain English, if an arrangement among men is not an arrangement which puts them all in the same business boat, then they cannot get into the same boat merely to seek the benefits of §§ 181 and 182. But if they are in the same business boat, although they may have varying re-

wards and varied responsibilities, they do not cease to be in it when the tax collector appears." *Id.* at 750-752, 754.³⁰

Second, if a partner contributes services to the enterprise, the question is not whether the services "are of sufficient importance to meet some objective standard" of the Tax Court, but whether the services indicate an intention to join in the enterprise. *Id.* at 742.³¹ Third, regardless of services the donee of an intra-family gift can "become a partner through investment of the capital in the family partnership." *Id.* at 745. "Original capital" is not "an essential test of membership in a family partnership." *Id.* at 748. Whether the donee has made an investment of gift-capital depends on whether the gift is a true transfer of a participating interest or "mere camouflage." *Id.* at 746-747.³² Fourth, if partners have "agreed that the services or capital to be contributed presently by each is of such value to the partnership that the contributor should participate in the distribution of profits, that is sufficient." There is "room for an honest difference of opinion as to whether the services or capital furnished by the alleged partner are of sufficient importance to justify his inclusion in the partnership." The Tax Court cannot "substitute its judgment for that of the parties." *Id.* at 744-745.³³

³⁰ For further opinions to the same emphatic effect, see *Miller v. Commissioner*, 183 F. 2d 246, 252-253 (6th Cir. 1950); *Lamb v. Smith*, 183 F. 2d 938, 941 (3d Cir. 1950); *Barrett v. Commissioner*, 185 F. 2d 150, 157-158 (1st Cir. 1950) (concurring opinion of Magruder, J.); *Cobb v. Commissioner*, 185 F. 2d 255, 258 (6th Cir. 1950); *Ginsburg v. Arnold*, 185 F. 2d 913, 916 (5th Cir. 1950).

³¹ See also *Tomlinson v. Commissioner*, 199 F. 2d 674, 676 (5th Cir. 1952).

³² See further decisions cited in note 37, *infra*.

³³ See also *Stanchfield v. Commissioner*, 191 F. 2d 826, 828 (8th Cir. 1951); *Turner v. Commissioner*, 199 F. 2d 913, 916 (5th Cir. 1952); *Estate of Dorsey v. Commissioner*, 214 F. 2d 294, 299 (5th Cir. 1954); *Scotfield v. Davant*, 218 F. 2d 486, 489 (5th Cir. 1955).

The Court of Claims has succinctly restated the essence of the *Culbertson* decision as it affects donee-partners. *Williamson v. United States*, 152 F. Supp. 716 (Ct. Cls. 1957). "One may avoid paying taxes on the future income from his property by the drastic remedy of giving away his property. Such a gift may be to anyone at all, certainly including his children. It may be of land, stocks, bonds, or any other kind of property. It may be of a corporate interest or an undivided interest. The only question pertinent in an income tax case is whether he really gave the property away, or only pretended to give it away in order to escape or reduce the taxes on the income." The same settled principle applies to "shares in partnerships as well as to other kinds of property, and even if the partnerships are family partnerships." "Further, the Court in *Culbertson*, held in effect that it is not for the Commissioner of Internal Revenue or the courts to review the action of the parties to the partnership agreement, and, if they determine that the contributions of the questioned partners were not worth what they cost the admitted partners in sharing the profits with them, disregard, for tax purposes, the partnership agreement." 152 F. Supp. at 719.

The rules enunciated in *Commissioner v. Culbertson* are to be read *in pari materia* with the committee reports relating to the later legislation on family partnerships. See Revenue Act of 1951, § 340, amending § 3797(a)(2) and adding § 191 of the 1939 Code; H. R. Rep. No. 586, 82d Cong., 1st Sess. 32 *et seq.* (1951); Sen. Rep. No. 781, 82d Cong., 1st Sess. 38 *et seq.* (1951).³⁴ Though the legislation of 1951 is not retroactive, this Court has appropriately held that the committee reports should nevertheless be

³⁴ Section 3797 (a)(2) of the 1939 Code, as amended, provides: "A person shall be recognized as a partner for income tax purposes if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person." See also Int. Rev. Code of 1954, § 704 (e)(1).

“taken into consideration” as very relevant indicia of “the prior status of the law.” *Toor v. Westover*, 200 F. 2d 713, 716 (9th Cir. 1952); *Parker v. Westover*, 221 F. 2d 603, 607 (9th Cir. 1955). See also *Alexander v. Commissioner*, 194 F. 2d 921, 923-924 (5th Cir. 1952); *Thomas H. Brodhead*, 18 T.C. 726, 735 (1952), *aff’d*, 210 F. 2d 652 (9th Cir. 1954). The 1951 legislation is not a sharp departure from the past. The Congressional committees pointedly declared that the newly enacted legislation was designed to express existing tax law, which the Tax Court persistently failed to apply despite the Supreme Court’s admonition in the *Culbertson* case. See H. R. Rep. No. 586, *supra*, at 32-33; Sen. Rep. No. 781, *supra*, at 39. “The House and Senate Reports concurred in finding such additional section was necessary to curb the Tax Court in its erroneous interpretation, since the *Culbertson* decision, of 26 U.S.C.A. Section 182.” *Forman v. Commissioner*, 199 F. 2d 881, 884 (9th Cir. 1952).

“Two principles governing attribution of income,” the reports state, “have long been accepted as basic: (1) income from property is attributable to the owner of the property; (2) income from personal services is attributable to the person rendering the services. There is no reason for applying different principles to partnership income. If an individual makes a bona fide gift of real estate, or of a share of corporate stock, the rent or dividend income is taxable to the donee.” The amendment expresses the same principles. It makes “clear that, however the owner of a partnership interest may have acquired such interest, the income is taxable to the owner, if he is the real owner. If the ownership is real, it does not matter what motivated the transfer to him or whether the business benefited from the entrance of the new partner.” H. R. Rep. No. 586, *supra*, at 32; Sen. Rep. No. 781, *supra*, at 38-39.

The reports next comment perceptively on the aberrations of the Tax Court. “Although there is no basis under

existing statutes for any different treatment of partnership interests, some decisions in this field have ignored the principle that income from property is to be taxed to the owner of the property." The reports particularly criticize the Tax Court's frequent refusal, since the *Culbertson* decision, to recognize partnerships "which arose by virtue of a gift of a partnership interest from one member of a family to another." The erroneous course of the Tax Court, the reports indicate, is not obscured by its repeated references to such verbalisms as "intention," "business purpose," "reality," and "control." In view of the Tax Court's deviations a statute is required "to make clear the fundamental principle that, where there is a real transfer of ownership, a gift of a partnership interest is to be respected for tax purposes without regard to the motives which actuated the transfer." H. R. Rep. No. 586, *supra*, at 32-33; Sen. Rep. No. 781, *supra*, at 39.

The reports also illuminate the legal content of a gift of a partnership interest. The same standards apply in determining the bona fides of such transfers as in determining the bona fides of other transfers between family members. Moreover, a "restriction" on the donee's "complete and unfettered control" of the donated property does not necessarily mean that the alleged gift is a sham. "Contractual restrictions may be of the character incident to the normal relationships among partners. Substantial powers may be retained by the transferor as a managing partner or in any other fiduciary capacity which, when considered in the light of all the circumstances, will not indicate any lack of true ownership in the transferee. In weighing the effect of a retention of any power upon the bona fides of a purported gift or sale, a power exercisable for the benefit of others must be distinguished from a power vested in the transferor for his own benefit." H. R. Rep. No. 586, *supra*, at 33; Sen. Rep. No. 781, *supra*, at 39-40.

We have said that the committee reports of 1951 mirror the pre-existing law governing family partnerships. This

view is confirmed by Mim. 6767, 1952-1 Cum. Bull. 111, in which the Commissioner has painstakingly appraised the *Culbertson* decision. As this Court has stated, Mim. 6767 has "recognized" the "principles set forth" in the legislation of 1951 and the related committee reports. *Parker v. Westover, supra*, at 607. More specifically, the Commissioner accepts the principle that if capital is a material income-producing factor, a donee of a capital interest in the firm qualifies as a partner. The question, simply, is whether the gift is real or feigned. If the gift is real, it makes no difference that the donee fails to contribute services. In Mim. 6767 the Commissioner particularly denies that there is some separate and additional requirement of "business purpose." "An individual is entitled fully to dispose of his or her property so far as the income tax law is concerned, and may give or sell interests in a business to members of his family. The question with which the law concerns itself is whether the individual has really done so. There is no requirement that intra-family gifts be motivated by a business purpose, which frequently they would not have, before the donee may be recognized as the owner, for income tax purposes, of the property given to him, and the same is true of other antecedent family transactions." "Business purpose" is "satisfied by the single fact (if it be a fact) that the alleged partner has invested in the business money or property, useful to the business, of which he or she is the real owner," even if "such money or property had already been used in the business before the alleged partner acquired any interest therein." *Id.* at 117. See also *Henslee v. Whitson*, 200 F. 2d 538, 540 (6th Cir. 1952).³⁵

³⁵ The Sixth Circuit has stated that "business purpose" is "the continuation and operation of the partnership business." If the donee-partner's "ownership is real, it does not matter what motivated the transfer or whether or not the business profited from the entrance of the new partner." *Wayne v. Glenn*, 222 F. 2d 549, 551 (6th Cir. 1955). See further *Maloney v. Tunnell*, 218 F. 2d 705, 707 (3d Cir. 1955), which indicates that the phrase "business purpose" is not "a requirement that the business enterprise must be benefited by or improved by changing into a partnership."

In the light of the controlling principles we return to the immediate issue. Under those legal standards of judgment Dora must be recognized as a partner unless her interest in the firm was "a mere pretense and a sham." *Seabrook v. Commissioner*, 196 F. 2d 322, 326 (5th Cir. 1952); see pp. 84-85, *supra*. And here there is no occasion for such derogatory catch words and labels unless the legal standards are to be cast aside along with the record.

The evidential facts are essentially undisputed. As the Tax Court itself found, E. Royce gave Dora a capital interest in the business and she executed the articles of partnership along with the other members of the firm. (R. 263-266, 277.) She not only signed as a partner, but was held out as a partner. See pp. 11-12, *supra*. Under the partnership agreement she "had the same legal rights and liabilities as did the other partners with respect to the firm." *Whayne v. Glenn*, 222 F. 2d 549, 551 (6th Cir. 1955). See also *Stanchfield v. Commissioner*, 191 F. 2d 826, 829 (8th Cir. 1951). E. Royce did not retain any special powers or privileges which rendered her interest illusory. Along with the other partners she had "an equal voice" in the business while the partnership continued, and along with them she was to receive her share of the surplus when it dissolved. (R. 265.) The firm continuously kept books which reflected her capital account, her share of the earnings, her periodic drawings, and the balance to her credit. Whenever distributions were made, she took her aliquot portion. See pp. 12-14, *supra*.

Dora had become a full-fledged partner through a gift of a capital interest in the firm. See pp. 84-88, *supra*. Nor is there any doubt that the transfer was complete. It was "permanent, with no interest retained" by E. Royce. "There was no subterfuge or sham about what

he did." *Theodore D. Stern*, 15 T.C. 521, 525 (1950).³⁶ Both E. Royce and Dora positively testified that a true transfer was intended and a true partnership was formed. The Commissioner did not impair their testimony by cross-examination or any evidence of his own. "There are no findings that the witnesses are not to be believed; and any findings that might be made to that effect would be without substantial evidence to sustain them." *Kent v. Commissioner*, 170 F. 2d 131, 138 (6th Cir. 1948). Dora's interest as a partner was no less real than her husband's, and so her share of the firm's income cannot be taxed to him. Our conclusion falls well within the many decisions which hold that the donee of a capital interest in a partnership must be recognized as a partner, quite apart from any services which he may or may not perform.³⁷

So far we have focused on Dora's capital interest in the firm. However, even aside from her investment in the business, Dora qualified as a partner because of the

³⁶ The gift was in stock of the predecessor corporation, which Dora then turned in for her partnership interest. Of course, the fact that E. Royce expected her to join the firm did not affect the definitive nature of her acquired interest. See, e.g., *Walberg v. Smyth*, 142 F. Supp. 293, 297 (N.D. Calif. 1956); *Theodore D. Stern*, *supra*, at 526; *John J. Cunningham*, 10 T.C.M. 800, 801 (1951).

³⁷ See *Lamb v. Smith*, *supra*; *Ginsburg v. Arnold*, *supra*; *Seabrook v. Commissioner*, *supra*; *Henslee v. Whitson*, *supra*; *Marcus v. Commissioner*, 201 F. 2d 850 (5th Cir. 1953); *Nicholas v. Davis*, 204 F. 2d 200 (10th Cir. 1953); *Scofield v. Mauritz*, 206 F. 2d 135 (5th Cir. 1953); *Commissioner v. Brodhead*, 210 F. 2d 652 (9th Cir. 1954), *aff'g* 18 T. C. 726 (1952); *Estate of Dorsey v. Commissioner*, 214 F. 2d 294 (5th Cir. 1954); *Scofield v. Davant*, *supra*; *Fly v. Cole*, 219 F. 2d 653 (5th Cir. 1955); *Wayne v. Glenn*, *supra*; *Williamson v. United States*, *supra*; *Buerger v. United States*, 115 F. Supp. 600 (D. Ala. 1953); *Walberg v. Smyth*, *supra*; *Culbertson v. United States*, 56-1 U.S.T.C. ¶ 9356 (N.D. Tex. 1956); *Goldberg v. United States*, 152 F. Supp. 259 (E.D.N.Y. 1957); *Dickstein v. McDonald*, 149 F. Supp. 580 (M.D. Pa. 1957); *Edward A. Theurkauf*, 13 T.C. 529 (1949); *John A. Morris*, 13 T.C. 1020 (1949); *Clarence B. Ford*, 19 T.C. 200 (1952); *Estate of A. C. Hewitt, Sr.*, 9 T.C.M. 383 (1950); *James J. Gravley*, 9 T.C.M. 821 (1950); *Earl Rhine*, 9 T.C.M. 1078 (1950); *Juliana Schroeder*, 11 T.C.M. 8 (1952); *Royce Kershaw*, 12 T.C.M. 1051 (1953); *Ben Travis Everett, Sr.*, 13 T.C.M. 155 (1954).

services which she contributed. See pp. 83-84, *supra*. Again the significant evidential facts speak very clearly for themselves. See pp. 12-13, *supra*. Dora was a full "working partner." (R. 434.) She shared in the day-to-day operation of the business, and she participated in firm meetings. She was an experienced business woman, and her views were well received and respected. (R. 446.) Cf. *Pike v. United States*, 231 F. 2d 688, 693 (9th Cir. 1956). Her services were important to the enterprise. (R. 430, 450, 542.) If she had not been active in the business, the firm would have had to employ someone else to do her work. (R. 277.) In the Seattle partnership her work was done by "an excellent top-flight man" whom it would be "hard" to replace. (R. 468.) Dora had performed the same services for the prior corporation, and her valuable help had prompted E. Royce to give her a capital interest in the partnership. (R. 450.) Cf. *Ardolina v. Commissioner*, 186 F. 2d 176, 181-182 (3d Cir. 1951). This is not a case where the wife "knew nothing about" the business, "except as a wife ordinarily has general knowledge of her husband's business." *Clarence B. Ford*, 19 T.C. 200, 202 (1952). And Dora's services were obviously "greater than those ordinarily rendered by a wife in her husband's business." *Hartz v. Commissioner*, 170 F. 2d 313, 318 (8th Cir. 1948), *cert. denied*, 337 U. S. 959 (1949). Actually, Dora and E. Royce were the only working partners in the business after November 28, 1942. See p. 12, *supra*.

The Tax Court tries to dispose of Dora's services by characterizing them as "relatively inconsequential." (R. 277.) This disparaging description is no less irrelevant than erroneous. Cf. *Wellington v. Commissioner*, 196 F. 2d 421, 423 (7th Cir. 1952). What the Tax Court has done is to evaluate Dora's services in response to "some" elusive "objective standard" of its own—the very sort of approach which the Supreme Court condemned in *Commissioner v. Culbertson*, *supra*, at 742. It

is not for the Tax Court to say whether certain services are "vital" or otherwise. See *Tomlinson v. Commissioner*, 199 F. 2d 674 (5th Cir. 1952); and see further pp. 84-85, *supra*. Moreover, we are unaware that the Tax Court is especially competent to appraise the importance of services in a taxicab business—particularly where its judgment is wholly at odds with the testimony of those who are presumably informed. The essence of the matter is that husband and wife were working together in accordance with their respective abilities. The fact that E. Royce had more managerial responsibility does not obscure Dora's interest as a partner. *Funai v. Commissioner*, 181 F. 2d 890, 895 (4th Cir. 1950). The delegation of authority in a partnership is "a common practice which is necessary for orderly and convenient operation of such a joint enterprise." *Ginsburg v. Arnold*, 185 F. 2d 913, 915 (5th Cir. 1950). See also *Snyder v. Westover*, 217 F. 2d 928, 935 (9th Cir. 1954).

The Tax Court devotes one meager paragraph to its effort to rationalize its legal conclusion. Its few observations in this paragraph are scarcely illuminating.

The court first notes that the checks covering the distributions "were used to pay income taxes or were largely invested by the husband in various projects in which he was interested." (R. 277.) We fail to see how Dora's payment of taxes on her share of the profits suggests that those profits belonged to E. Royce. Certainly, the Tax Court does not imply that Dora's interest as a partner would have been more firmly established if she had failed to pay her taxes. In addition, the Tax Court is less than meticulous in its remark on alleged investments by her husband. A number of years after Dora acquired her interest in the Portland partnership, she loaned E. Royce \$70,000 for investment in a mining corporation.³⁸ See

³⁸ The corporation was organized in January, 1947. (Ex. 45-SSSS.)

pp. 15, *supra*. Nothing in the evidence indicates that the loan derived from a mere abject acquiescence in her husband's wishes. On the contrary, the evidence shows that Dora was a woman with a substantial business background and a judgment of her own. Whatever income she made available to E. Royce on loan "was wholly dependent upon her consent." *Estate of Charles H. Trafton*, 27 T.C. 610, 617 (1957). Dora spent and invested her partnership income as she saw fit. At the same time E. Royce continued to pay the ordinary expenses of the household. See pp. 14-15, *supra*.³⁹

The Tax Court next points to the lack of any evidence that E. Royce filed a gift tax return covering his transfer of shares in the corporation preceding the partnership. (R. 277.)⁴⁰ Here we may echo Hamlet and say that the court "doth protest too much." It is methodically emphasizing what it obviously regards as unimportant. For, as the court found, E. Royce filed a gift tax return reporting his transfer of shares in the Seattle enterprise (R. 267); yet there, too, the court refused to recognize Dora as a partner. See pp. 95-97, *infra*.

Last, the Tax Court obtains some comfort from the following observation: "Inconsistent with her testimony that she performed important services are the statements or the frequent omissions in certain of the partnership returns signed and sworn to by E. Royce indicating that Dora performed no services for the partnership." (R. 277.) E. Royce firmly testified that the erroneous statements about Dora were "typed" in by some employee "who didn't know anything about it." (R. 452-454.) A mistake

³⁹ We are not implying that a wife's partnership interest is to be mechanically disregarded if she helps pay the ordinary household expenses. See *Wilson v. Commissioner*, 161 F. 2d 661 (7th Cir. 1947); *Lamb v. Smith*, *supra*; *Estate of Dorsey v. Commissioner*, *supra*; *James J. Gravley*, *supra*.

⁴⁰ E. Royce explained that he did not report the gift because at that time he took care of his own tax returns and was unaware of any need to file returns of gifts. (R. 445.)

of this kind "may indicate carelessness, but it does not, in our opinion, negative or overcome the evidence that a partnership as claimed was created and did exist." *George E. Reynolds*, 26 T.C. 1225, 1239 (1956).⁴¹ In any event, the Tax Court itself has very ably answered itself. The court clearly dismissed the so-called "statements" and "frequent omissions" in finding that Dora did contribute services that are normally performed by an employee. (R. 272.) This factual determination necessarily rests on the testimony of E. Royce and Dora which the court must have found persuasive. It is not difficult to understand why the court was unimpressed by the erroneous entries on the partnership returns. Whoever made them did not regard them as very meaningful. The same returns (Ex. T, V, W, X) contained related entries stating that B. Royce spent 50 percent of his time in the business, but actually he visited Portland only three or four times a year. (R. 518.) The Tax Court pursued a curious course here. It rejected the entries for the purpose of fact finding and then resorted to them for the purpose of legal reasoning.

We conclude that the Tax Court erred as a matter of law in holding that Dora was not a member of the Portland partnership. There is no finding of sham or lack of good faith in the formation of the firm. See *Snyder v. Westover*, *supra*, at 935. Even if such a finding were made, it would not be responsive to the evidence. The Tax Court's "attribution" of Dora's income to E. Royce was "a distortion of the undisputed facts and a misapplication of the law contrary to the truth and right of the case." *Scofield v. Mauritz*, *supra*, at 141. On the basis of either her capital or her services, Dora was entitled to be recognized as a partner. The Tax Court, however, disregarded both her capital and her services. Dora and E. Royce "are in

⁴¹ In the *Reynolds* case the wife's individual tax return erroneously reported her share of partnership profits as compensation for services, and this mistake was but one among others.

the same business boat." They "do not cease to be in it" because the Commissioner has appeared on the scene. See pp. 83-84, *supra*.

While the Tax Court referred to the *Culbertson* case, it paid scant attention to its principles. They were honored in the breach rather than in the observance. The decision below should be reversed, unless the principles are to become "little more than mumbo jumbo" enabling the Tax Court to do as it pleases. See *Tomlinson v. Commissioner, supra*, at 675. As the Sixth Circuit bluntly stated in reversing the Tax Court, "To some people, the idea of having a wife carry on a business as a partner of her husband seems incredible and to be explained only as some kind of deception. What might be found as to the intention of husband and wife to operate a business as copartners could conceivably be colored by unconscious attitudes as to woman's place in society or views as to the marriage relationship." *Miller v. Commissioner*, 183 F. 2d 246, 253 (6th Cir. 1950).

IV.

DORA F. ROYCE IS A MEMBER OF THE SEATTLE PARTNERSHIP AND HER DISTRIBUTIVE SHARE OF THE INCOME IS NOT TAXABLE TO E. ROYCE

We now turn to the first issue involving Yellow Cab Company, a partnership doing business in Seattle, Washington.

On May 1, 1944, Dora acquired a capital interest in the Seattle partnership through a gift made by E. Royce on April 20, 1944. The firm consisted of ten members. Dora's interest was about 7 percent and E. Royce's interest was about 5 percent.⁴² Neither of the two was active in the business. Another partner, A. H. Wenck, was managing partner in direct charge of the enterprise. As in the case of the Portland partnership, Dora executed the articles of

⁴² The trust created by E. Royce for his daughter Eunice had an interest of about 13 percent. See further p. 97, *infra*.

partnership and the Certificate of Assumed Name; she had her own capital and drawing account on the books of the partnership; and she received her share of the profits along with the others. See pp. 15-19, *supra*. Here, too, the Tax Court has ruled that Dora "was not a bona fide partner." As a result, her share of the profits for the years 1945-1947 has been taxed to E. Royce as his income. (R. 275-278.)

Though in our view the Tax Court clearly erred in regard to the Portland partnership, we are even less able to understand its rationalizations on the Seattle partnership. Neither Dora nor E. Royce actively participated in the Seattle enterprise. Both were essentially passive investors in a business whose income derived from capital plus the efforts of others. She owned her interest as fully as he owned his, and the firm income was no more attributable to him than to her. See *Jones v. Baker*, 189 F. 2d 842, 844 (10th Cir. 1951); *Arthur A. Byerlein*, 13 T.C. 1085, 1091-1092 (1949). And as a mere owner of about 5 percent, he could scarcely exercise undue dominion over partnership affairs even if he were so inclined. In these and similar circumstances, where the income is divorced from any services by the donor-partner, the courts consistently hold that he cannot be taxed on the profits of the donee-partner. *Jones v. Baker*, *supra*; *United States v. Atkins*, 191 F. 2d 146 (5th Cir. 1951); *T. W. Rosborough*, 8 T.C. 136 (1947); *Arthur A. Byerlein*, *supra*; *William Collins, Sr.*, 7 T.C.M. 830 (1948); *Estate of A. C. Hewitt, Sr.*, 9 T.C.M. 383 (1950); *R. G. Bock*, 9 T.C.M. 709 (1950); *Edna Jurgensen*, 9 T.C.M. 1027 (1950); *Juliana Schroeder*, 11 T.C.M. 8 (1952).

Apparently here the Tax Court failed to recall what it thoughtfully held on prior occasions. For example, in *Edna Jurgensen*, *supra*, at 1029, the court stated on the basis of the *Culbertson* case, "It is possible for one who owns capital in a business, but who performs no services

for that business, to make a gift of a part of his capital interest so that thereafter the income from the business attributable to the capital given away is no longer taxable to the donor." The Tax Court made no attempt to explain why the same principle does not apply here. If the attempt had been made, we doubt whether much would have been added. There is no more reason to disregard Dora's interest than to ignore E. Royce's interest. The Tax Court wrongfully attributed to him "the income resulting from the wife's interest in the partnership." *Arthur A. Byerlein, supra*, at 1092.

V.

THE TRUST FOR EUNICE M. ROYCE IS A MEMBER OF THE SEATTLE PARTNERSHIP AND ITS DISTRIBUTIVE SHARE OF THE INCOME IS NOT TAXABLE TO E. ROYCE

The final question involves the trust which E. Royce created for the benefit of his daughter Eunice.

Again the relevant evidential facts are not in dispute. On April 20, 1944, E. Royce executed the declaration of trust. On the same date he transferred to himself, as trustee, 700 shares of stock in Yellow Cab Company of Seattle. When the partnership succeeded the corporation, he signed the articles of partnership as trustee. The capital interest of the trust was about 13 percent. The books of the partnership reflected a separate account for the trust; the trust received its proportionate share of the distributions; and all distributions to the trust were by checks payable to E. Royce as trustee. The checks, in turn, were deposited in a separate trust account. See pp. 19-21, *supra*.

What we have said about Dora's interest in the Seattle partnership also applies to the trust's interest. None of the firm income was attributable to personal services of E. Royce. He was simply a passive investor in the enterprise, and there is no more reason to disregard the trust's

interest than his interest. The trust owned its share of partnership capital just as completely as E. Royce owned his and Dora owned hers. See *Edna Jurgensen, supra*.⁴³ A trust may become a partner through a gift of a capital interest just as an individual may become a partner through an outright transfer. *Henslee v. Whitson, supra*; *Miller v. Commissioner*, 203 F. 2d 350 (6th Cir. 1953); *Scofield v. Mauritz, supra*; *Commissioner v. Brodhead*, 210 F. 2d 652 (9th Cir. 1954), *aff'g* 18 T.C. 726 (1952); *Commissioner v. Sultan*, 210 F. 2d 652 (9th Cir. 1954), *aff'g* 18 T.C. 715 (1952); *Commissioner v. Eaton*, 210 F. 2d 653 (9th Cir. 1954), *aff'g* 11 T.C.M. 734 (1952); *Pike v. United States*, 231 F. 2d 688 (9th Cir. 1956); *Goldberg v. United States*, 152 F. Supp. 259 (E.D.N.Y. 1957); *Dickstein v. McDonald*, 149 F. Supp. 580 (M.D. Pa. 1957); *Theodore D. Stern, supra*; *Clarence B. Ford, supra*.

The Tax Court attempts to distinguish the *Stern* and *Brodhead* decisions with the bare comment that they "are clearly distinguishable on their facts and are of no application here." (R. 288.) However, the Tax Court has discovered some adverse distinction where none exists. Under those decisions the trust for Eunice *a fortiori* qualified as a partner.

In the *Stern* case the taxpayer was controlling stockholder of a close corporation. Because of the excess profits tax he decided to operate through a partnership. He also realized that his own taxes would be less if he gave part of his interest to members of his family. "He chose to use trusts rather than transfer the interests directly to his wife and children so that he could retain control over the

⁴³ In the *Jurgensen* case, which also involved a partnership interest of a daughter, the taxpayer's evidence was substantially less favorable than here. For example, the books did not carry any separate income or capital account for the daughter. Her interest and her parents' interests were "lumped" in one family account. No distributions of earnings to the daughter were intended or made. And when her interest was sold, her share of the proceeds was used to pay a debt of the taxpayer. 9 T.C.M. at 1029-1030.

business and also prevent any part of it from getting" beyond his immediate family. 15 T.C. at 522. The taxpayer established four trusts for his wife and sons to which he transferred portions of his stock. He designated himself as trustee with broad powers of administration. Under the terms of the trusts the corpus was not distributable until after his death unless he provided otherwise. After the trusts were set up, the corporation was dissolved and the business was transferred to a limited partnership. The taxpayer was the sole general partner, and the trusts as well as the other members were limited partners.

The Commissioner refused to respect the trusts as partners, and taxed their share of the profits to the taxpayer. The Tax Court disagreed. It held that the taxpayer had made valid gifts in trust, and that the trusts were partners. "There was no subterfuge or sham about what he did." And his "plan to form a partnership" did "not vitiate the gifts." He "intended to make gifts of the shares and he actually transferred them to the four trusts." The gifts "were permanent, with no interest retained" by him. "There was no reason why he could not give those shares to the trusts. He did every important thing that could be done to give the shares to the trusts. A person may make a complete and valid gift to a trust of which that person is the trustee." After the transfers in trust the taxpayer "never exercised any dominion or control over the shares, except in his fiduciary capacity as trustee." It was unimportant that instead of making outright gifts, he "kept the beneficiaries, as such, out of the business." Though he "retained entire control in himself," it was "of no particular significance since limited partners normally have no part in the control or management of the business." "A substantial economic change took place" in which the taxpayer "gave up, and the beneficiaries indirectly acquired an interest in, the business." 15 T.C. at 525-527.

In the *Brodhead* case the Commissioner did not fare any better. There the taxpayer was the sole proprietor of a merchandising business. He transferred a half interest to a trust for his children, and then formed a limited partnership with the trust. He was the general partner and the trust was a limited partner. A trust company and a business acquaintance were trustees, but they could not exercise their powers of investment without the taxpayer's consent. Similarly, they could not assign the partnership interest of the trust without his approval. As of the date of trial, none of the income from the partnership had been distributed. The Tax Court held that the trust was a partner, and therefore its half of the profits could not be taxed to the grantor. This Court affirmed "on the grounds and for the reasons stated in the Tax Court's findings and opinion." 210 F. 2d at 653.

The Tax Court's reasons moved easily to its conclusion. The taxpayer, the court stated, irrevocably parted with 50 percent of his ownership, which was then contributed by the trust to the partnership. The fact that the contribution consisted of gift capital was immaterial, for the contribution had become the property of the trust. The taxpayer's retained control similarly had no adverse effect. "Trusts normally provide for some degree of control over corpus and/or income by someone other than the beneficiary. If they did not, the transfer would result in an outright gift rather than the creation of a trust." And if "the settlor retains power to control the trustee in some respects in the administration of the trust, the settlor is ordinarily under a fiduciary duty to the beneficiary in respect to the exercise of the power." 18 T.C. at 733-734.

The Tax Court then referred to "the expressed view" of the 1951 committee reports⁴⁴ that "partnership income, where capital is a material income-producing factor, should

⁴⁴ See pp. 85-87, *supra*.

be taxed to the partners if they were the real owners of their interests regardless of how the interests may have been acquired." While the 1951 legislation was not retroactive, "the basic principle of taxing income from property to the owner of the property was the law in the earlier years as fully as it is today." Moreover, as the reports stated, a transferee does not necessarily lack "true ownership" because of powers retained "as a managing partner or in any other fiduciary capacity when considered in the light of all of the circumstances." Brodhead's powers over the corpus in the business "were no more than those of a managing partner, and in the exercise thereof he was required to act in a fiduciary capacity. After a gift is once complete and title has passed to the donee, the fact that the donor subsequently has possession of it does not affect its validity." *Id.* at 735-736.

If any important differences distinguish the present case from the *Stern* and *Brodhead* cases, they are differences which militate against the Commissioner. In those cases each grantor operated the business as sole general partner. Here someone else ran the business. There each grantor contributed significant services as well as capital. Here the grantor was a mere passive investor. There each grantor, as sole general partner, controlled the flow of income to the trust. Here the grantor was but one partner among many. In short, the decision below cannot be sensibly squared with the two decisions which the Tax Court has so casually put aside.

The Tax Court seeks to fortify its conclusion by remarking that no "substantial change" was "made in the economic position of E. Royce or in the management and control of the Seattle partnership. The capital donated by E. Royce to himself as trustee and then, in turn, to the Seattle partnership was part of that which he had previously employed in the business. The conduct of the business remained unchanged." (R. 288.) All this emphasis is con-

cerned with the irrelevant.⁴⁵ Of course, the trust did not affect the "conduct of the business" or its "management and control." For E. Royce had nothing to do with the operation of the business. He was an inactive investor before the trust was created, and he remained an inactive investor after it was created—except that he had given away a portion of his investment.

The Tax Court additionally notes that under the trust instrument E. Royce had broad powers to manage and invest, and to accumulate or distribute income. (R. 288.) But the court at the same time concedes that these powers of administration were bestowed on him as trustee. (R. 288.) Since they were held as trustee, they were fiduciary powers; and fiduciary powers do not disqualify a trust from becoming a partner. *Miller v. Commissioner, supra*, at 353. See further pp. 87, 99-101, *supra*.⁴⁶

As a further reason for ignoring the trust, the Tax Court refers to the loans made by the trust to E. Royce. These loans, says the court, were made "with no more apparent restraint than there would have been had the trust never been declared." (R. 288.) We do not see how the loans impaired the bona fide existence and ownership of the trust. Whenever loans were made, the obligation to repay was

⁴⁵ The Tax Court's argument at this point further reflects its departure from the *Stern* and *Brodhead* decisions. There the trusts were recognized as partners though they were deliberately designed to preserve the grantor's management and control of the business.

⁴⁶ The Tax Court cites, as an adverse factor, E. Royce's failure to "file fiduciary income tax returns for the trust." (R. 282.) Here there seems to be much ado about little. According to the Tax Court's own findings, E. Royce filed separate returns of the trust income which he signed as trustee. (R. 282.) In reporting the trust income he erroneously used the individual tax form because he was unfamiliar with the special form devised for trusts. However, the genuineness of the trust is not in the least affected by this innocent mistake of the trustee. As the Fourth Circuit held, in regard to an analogous failure to file a proper return, tax liabilities are not to be distorted because the taxpayer did not fully "know all the legal consequences of his every act." *Funai v. Commissioner, supra*, at 894. The income tax is not a penalty imposed on laymen for a pardonable lack of legal expertise.

recognized. At the end of 1949 the loans came to \$94,100. Of this total, \$7,100 was advanced to Royce, Inc., and \$87,000 to E. Royce personally. Royce, Inc. repaid the \$7,100 with interest in 1950. As of December 31, 1954, E. Royce had repaid \$5,515, and the balance is represented by notes. See p. 21, *supra*.

In the present context we need not pause to consider whether E. Royce may have strayed beyond the fiduciary limitations which hedge his discretion as trustee. This case involves the taxability of income received by the trust. It "is not concerned with how faithfully the trustee discharged his duties." *Walberg v. Smyth, supra*, at 297. As this Court stated in similar circumstances, whether the loans "constituted sound trust management, or even amounted to misconduct on the part of the trustee, is a question of state law." It does not affect the question whether the trust has otherwise become a partner. See *Pike v. United States, supra*, at 694. The Tax Court itself recognized, in a less favorable situation, that a father's loan from his daughter did not disturb her interest as a partner. *Edna Jurgensen, supra*. Even if E. Royce "took more liberties than the law allows," his action "was more referable" to his position as "head of the household than to any belief that he had not really and truly" made a gift. *Estate of Dorsey v. Commissioner, supra*, at 299-300. The income of a trust cannot be taxed to its grantor by ignoring the fiduciary restrictions which bind him under the principles of trust law. Cf. *Phipps v. Commissioner*, 137 F. 2d 141, 144 (2d Cir. 1943).⁴⁷

The Tax Court cites five decisions as if they inevitably lead to its conclusion. (R. 287.) These decisions are

⁴⁷ The Tax Court states, somewhat accusingly, that little income was distributed to Eunice. Since she was then a minor at school, there was no reason for substantial distributions. If the income had been generously applied for her maintenance, the Commissioner would be the first to argue that the trust should be ignored because its income had been used to discharge the grantor's legal obligation of support.

Economas v. Commissioner, 167 F. 2d 165 (4th Cir. 1948); *Zander v. Commissioner*, 173 F. 2d 624 (5th Cir. 1949); *Stanback v. Robertson*, 183 F. 2d 889 (4th Cir. 1950); *Feldman v. Commissioner*, 186 F. 2d 87 (4th Cir. 1950), *aff'g* 14 T.C. 17 (1950); and *Stanton v. Commissioner*, 189 F. 2d 297 (7th Cir. 1951), *aff'g* 14 T.C. 217 (1950). "The factual situation here," says the court, "cannot be satisfactorily distinguished" from those cases. (R. 287-288.) We consider it neither desirable nor appropriate to engage in a delicate balancing of precedents. We shall merely indicate very briefly that the cited cases hardly compelled the Tax Court to tax the income of the trust to E. Royce. None of them involved a donor-partner who was simply an inactive investor in a business operated by others.

In the *Economas* case the taxpayer was sole owner of a business. She transferred an interest of 25 percent to each of two trusts for her children. She then continued to manage the business as before. In making distributions to herself she arbitrarily retained the profits to which the trusts were simultaneously entitled. "The earnings were due entirely to the taxpayer's efforts and the monies credited on the books to the children, except for a small amount, remained in the business and could not be withdrawn without the taxpayer's consent." 167 F. 2d at 167. In the *Zander* case the taxpayer was also sole owner of the enterprise. He assigned 60 percent to trusts for his children. He then continued to operate the business as before. Except for a few incidental sums, the trusts received none of the profits. The taxpayer ran the business as if there were no trusts.

In the *Stanback* case the trusts were given interests as limited partners. The grantors were the general partners, who had complete control over the operation of the business and the distribution of profits. They were also free to reallocate the trust income within the families of the beneficiaries. In the *Feldman* case the taxpayer owned 35 percent of the business and transferred 13 percent in

trust for his son. Unlike E. Royce, he was actively engaged in the business, which "was created and apparently brought to its successful position largely through" his "efforts". 14 T.C. at 25. Furthermore, despite the recent *Culbertson* decision, the case was decided on the discredited ground that a donee of a partnership interest is not a partner for tax purposes unless he contributes "vital services" or there is some special "business purpose" for bringing him into the business. We have already noted that even the Commissioner has explicitly renounced any such principle. See Mim. 6767, discussed at pp. 87-88, *supra*; and see further pp. 84-85, *supra*.

The *Stanton* case does not require much more to be said. The taxpayer lost there for the simple reason that the alleged partnership was a mere assignee of his personal service income. In addition, he retained and then exercised a right to recapture the interest which he had allegedly given away.

The Tax Court erred in taxing the earnings of the trust to E. Royce.

CONCLUSION

The decisions of the Tax Court should be reversed.

Respectfully submitted,

LOUIS EISENSTEIN
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Counsel for Petitioners

APPENDIX

APPENDIX**I.****Statutes and Regulations Involved**

Act of June 25, 1948, 62 Stat. 945:

§ 1732. Record made in regular course of business; photographic copies.

(a) In any court of the United States and in any court established by Act of Congress, any writing or record, whether in the form of an entry in a book or otherwise, made as a memorandum or record of any act, transaction, occurrence, or event, shall be admissible as evidence of such act, transaction, occurrence, or event, if made in regular course of any business, and if it was the regular course of such business to make such memorandum or record at the time of such act, transaction, occurrence, or event or within a reasonable time thereafter.

All other circumstances of the making of such writing or record, including lack of personal knowledge by the entrant or maker, may be shown to affect its weight, but such circumstances shall not affect its admissibility.

The term "business," as used in this section, includes business, profession, occupation, and calling of every kind.

* * *

(28 U.S.C., 1952 ed., § 1732.)

Internal Revenue Code of 1939:

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(c) Distribution in Liquidation.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the dis-

tributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. * * *

* * *

(g) Redemption of Stock.—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

* * *

(i) Definition of Partial Liquidation.—As used in this section the term “amounts distributed in partial liquidation” means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

* * *

(26 U.S.C., 1952 ed., Sec. 115.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U.S.C., 1952 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

(26 U.S.C., 1952 ed., Sec. 181.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.115-5. Distributions in Liquidation.—Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation are to be treated as in part or full payment in exchange for the stock so canceled or redeemed. The gain or loss to a shareholder from a distribution in liquidation is to be determined, as provided in section 111 and section 29.111-1, by comparing the amount of the distribution with the cost or other basis of the stock provided in section 113; but the gain or loss will be recognized only to the extent provided in section 112, and shall be subject to the conditions and limitations provided in section 117.

The term “amounts distributed in partial liquidation” means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock. A complete cancellation or redemption of a part of the corporate stock may be accomplished, for example, by the complete retirement of all the shares of a particular preference or series and issuing new shares to replace a portion thereof, or by the complete retirement of

any part of the stock, whether or not pro rata among the shareholders.

In the case of amounts distributed in partial liquidation, the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of section 115(b) for the purpose of determining taxability of subsequent distributions by the corporation. (See sections 29.27(g)-1 and 29.115-11.)

* * *

Sec. 29.115-9. Distribution in Redemption or Cancellation of Stock Taxable as a Dividend.—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

The question whether a distribution in connection with a cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend depends upon the circumstances of each case. A cancellation or redemption by a corporation of a portion of its stock pro rata among all the shareholders will generally be considered as effecting a distribution essentially equivalent to a dividend distribution to the extent of the earnings and profits accumulated after February 28, 1913. On the other hand, a cancellation or redemption by a corporation of all of the stock of a particular shareholder, so that the shareholder ceases to be interested in the affairs of the corporation, does not effect a distribution of a taxable dividend. * * *

II.

Respondent's Exhibit A

I, STUART A. WIXSON, hereby certify as follows:

1. I reside at 124 Lake Drive West, Packanack Lake, New Jersey.

2. I am the Treasurer and Assistant Secretary of CROWN FINANCE COMPANY, Inc., a Delaware corporation, formerly American Business Credit Corporation, the name having been changed from American Business Credit Corporation to Crown Finance Company, Inc. in 1950.

3. There is attached hereto a copy of the Minutes of a meeting of the Executive Committee of American Business Credit Corporation, the Delaware corporation, held on June 20, 1945, at its office at 50 Church Street, New York, New York.

4. At the date of said meeting American Business Credit Corporation, the Delaware Corporation, owned all of the issued and outstanding capital stock of American Business Credit Corporation, an Oregon Corporation, which made the latter a wholly-owned subsidiary of the former.

5. As appears from the Minutes of the meeting of the Executive Committee hereto attached, American Business Credit Corporation, the parent corporation, approved the loan by its Oregon subsidiary, more fully referred to in said Minutes, in the amount of \$350,000.

6. Under the method of operation between American Business Credit Corporation, the Delaware corporation, and its wholly-owned Oregon subsidiary, American Business Credit Corporation would advance to its wholly-owned subsidiary funds needed by the Oregon subsidiary for the transaction of its business, and as appears from the records of the American Business Credit Corporation, the Delaware corporation, and its wholly-owned Oregon subsidiary said loan in the sum of \$350,000 was made

in July, 1945 and was repaid in the month of September, 1945.

7. That the Oregon subsidiary, American Business Credit Corporation, an Oregon corporation, was organized on or about the 25th day of August, 1943 and was dissolved on or about the 27th day of June, 1949, and certain of its records were transferred to the parent corporation in New York City, and that such records are in my general custody.

IN WITNESS WHEREOF, I have hereunto set my hand and seal this 21st day of April, 1955.

STUART A. WIXSON

STATE OF NEW YORK }
COUNTY OF NEW YORK } ss:

On this 21st day of April, 1955, before me personally came STUART A. WIXSON, to me known and known to me to be the individual described in and who executed the foregoing instrument.

CARROLL H. DONOHUE
Carroll H. Donohue
Notary Public,
State of New York
No. 30-0992650
Qualified in Nassau
County
Cert. filed with N.Y. Co.
Clk and Reg.
Term Expires March 30,
1957

AMERICAN BUSINESS CREDIT CORPORATION
MEETING OF EXECUTIVE COMMITTEE

Meeting of the Executive Committee was held in Suite 1460, 50 Church Street, New York, N. Y. on June 20th 1945 at 2:00 P. M. O'clock.

Present: Messrs. Burman, Cashmore and Kincaid of the Committee; and by invitation, Messrs. Dick and Ebe, Vice Presidents of the Corporation, and Mr. Davidson, Vice President of the Corporation's Portland, Oregon subsidiary.

Mr. Kincaid served as Chairman and Mr. Fitzgerald acted as Secretary thereof.

Messrs. Dick and Ebe presented details relating to a financing arrangement requested by Aetna Industrial Corporation, New York, N. Y. Aetna plans to purchase 100% of the capital stock of Utility Construction Co., Inc., New Brunswick, New Jersey for the sum of \$180,000. The Committee was informed Aetna will put up \$30,000 toward the purchase price and wishes to borrow the balance of \$150,000 from ABC. Utility is an old established contracting firm generally engaged in road building and supply of contractors materials.

We would loan Aetna \$150,000 on its demand corporate note and simultaneously Aetna would acquire all the stock of Utility, which would be pledged immediately to us. Within 35 to 40 days from date of our loan Aetna will repay us \$50,000 leaving a balance of \$100,000. At the same time, the accounts of Utility will be assigned to us, wherein the advance on such acceptable accounts will be not less than \$70,000, leaving a balance of \$30,000 on our original loan. If there are insufficient acceptable accounts receivable to permit us to advance \$70,000, Aetna will pay us in cash the difference between \$70,000 and the amount available on the acceptable accounts. Advance on receivables is to be 90% on non-notification basis. The

balance of \$30,000 is to be secured by a first mortgage on land, plant and equipment of Utility, the mortgage to remain unrecorded, unless Utility or Aetna is in default of any of its agreements with us. The mortgage note will be endorsed by Aetna, and ABC will retain as collateral the entire capital stock of Utility till the mortgage is repaid in full. The mortgage is to be repaid in 12 equal and consecutive monthly installments, first due 30 days after the date of the mortgage. We are to have a one year contract for financing the accounts receivable of Utility; over all charge on all money is 12% per annum.

The Committee reviewed in detail the financial condition of Utility Construction Co. as at our examination date, April 30th, 1945, and the operating results for prior years as reflected in the examination, together with the condition of Aetna Industrial Corporation as at our examination date, 12/31/44, and the company's statements as at 3/31/45. Mr. Dick and Mr. Ebe were interrogated in respect to the condition of both companies, and their opinions of the transaction. After reviewing the entire credit file, the Committee unanimously approved the lines as requested, with stipulations as follows:

1. Since Utility Construction is a contracting firm, receivables created will generally rise from contracts being performed. The Committee therefore requires that the Credit Department examine such contracts at the time receivables are assigned to be assured the receivables are in order and to be aware of any hold-back feature, etc.
2. Subject to approval of our counsel.

Mr. Davidson and Mr. Ebe then submitted an application on behalf of ABC-Portland. A group of outstanding individuals in Portland, headed by Messrs. Barney &

Roy Royce and Robert Jacob, desire to purchase the entire capital stock of Oregon Motor Stages, largest intra-state bus company operating in Oregon. Capital stock consists in all of 750 shares Common, par value \$100.00 per share, book value \$537.00 per share. The stock is to be acquired for a price of \$750,000. The purchasers intend to buy 400 shares for \$400,000, with their own funds. They ask that we extend a line of credit of \$350,000, the balance of the purchase price of the Oregon Motor Stages stock. We are asked to lend Mr. Roy Royce, personally, the sum of \$350,000, on his note, to be secured by all of the capital stock of Oregon Motor Stages. Our loan to be repaid in 90 days or adjusted as conditions warrant. Mr. R. Royce's personal statement reflects a net worth of \$1,366,000.00. Retiring stockholders will guarantee to R. Royce and his associates that the worth of Oregon Motor Stages is not less than the figure shown on the company's 4/30/45 statement. A fee of \$5,000 plus 5% per annum on cash for every 90 days is charge contemplated.

The Committee reviewed in detail the financial condition of Oregon Motor Stages as of 12/30/44 and 4/30/45 and its operating results for 1944. Mr. Davidson was questioned in respect to the proposed transaction and Mr. Dick's opinion was received. After consideration and full review, the Committee unanimously approved the credit line requested, subject to approval of counsel, and the following stipulations:

1. Subject to unanimous approval of full Portland Committee.

Mr. Davidson then presented for the Committee's consideration a proposal made by Mr. Buchanan, General Manager of Poole, McGonigle and Jennings, ship repairers in Portland. Mr. Buchanan desires to purchase the assets and liabilities of Hurley Marine Works, Inc. of Oakland,

California. Plant and machinery would not be purchased but leased for a term of two years, with an option to purchase. Hurley operates now under a War Shipping Administration master contract which would be acquired in the purchase. Volume of business done by Hurley in 1944 was \$12,000,000. We would be asked to consider 80% advance on receivables and a 60 day loan of \$300M against the acquiring company's capital stock and the assignment of the two year plant lease. The loan of \$300M would be repaid or converted in 45 days, to a receivable advance. Mr. Davidson said he was not asking for approval of credit lines at this time, but wanted the Committee's thoughts and instructions. The Committee agreed that the volume of business possible appeared attractive. By unanimous vote the Committee authorized Mr. Davidson to indicate our interest and determine whether such a transaction would be agreeable to the Seller. If so, Mr. Davidson was instructed to present the complete transaction for full Committee consideration.

Mr. Burman then presented details of an application by Music Acceptance Corporation. Mr. Mair of MAC and Mr. Hammergren of Wurlitzer Mfg. Co. had discussed with him, a proposed plan for financing the New Wurlitzer Orgatron. The Orgatron will sell at retail for about \$1,200 under Regulation "W" terms, direct collection, with finance charge of $1\frac{1}{2}\%$ per month on the unpaid balance for the number of months the transaction runs. Maximum advance by ABC would be 90%. MAC proposed that all dealer and distributor contracts be made in its name, and that ABC have a special set-up with MAC Chicago office so that all time sales created flow thru MAC. MAC proposed that ABC pay its employees in this set-up and as well as a portion of the rent for the space used. Further MAC proposed a maximum yield of 10% to ABC or that ABC pay MAC 25% of net charges. The Committee discussed the proposal

with Mr. Dick, and with Mr. DeMayo, Comptroller of the Corporation, who had been invited to attend this subject on the Committee agenda. After consideration the Committee approved extending a line of credit with the following stipulations:

1. That we would only consider the business offered on a basis of 11% per annum net yield to us.
2. We are not interested in any special operating set-up for Music Acceptance Corporation.

There being no further business, the Committee voted to adjourn.

S. J. FITZGERALD
Acting Secretary

III.

Table of Exhibits

	Identified	Offered	Accepted	Rejected
Petitioner's Exhibit 32	R. 323	R. 323	R. 324	
Petitioner's Exhibit 35	R. 416	R. 416	R. 417	
Petitioner's Exhibit 37	R. 439	R. 440	R. 440	
Petitioner's Exhibit 38	R. 440	R. 441	R. 441	
Petitioner's Exhibit 39	R. 442	R. 442	R. 443	
Petitioner's Exhibit 33	R. 494	R. 500	R. 500	
Petitioner's Exhibit 34	R. 498	R. 500	R. 500	
Petitioner's Exhibit 40	R. 509	R. 511	R. 512	
Petitioner's Exhibit 41	R. 512	R. 513	R. 513	
Petitioner's Exhibit 42	R. 514	R. 516	R. 516	
Petitioner's Exhibit 22	R. 535	R. 535	R. 535	
Respondent's Exhibit NNNN	R. 590	R. 590		R. 591
Respondent's Exhibit OOOO	R. 599	R. 600	R. 601	
Respondent's Exhibit A	R. 611	R. 611	R. 615	
Petitioner's Exhibit 43	R. 618	R. 619	R. 619	
Petitioner's Exhibit 44	R. 619	R. 620	R. 620	

